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**REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN
PARLIAMENT**

on the implementation of macro-financial assistance to third countries in 2002

LIST OF ABBREVIATIONS

CAMEL	Capital, assets, management, earnings, liquidity (parameters used in international system for rating banks)
CBA	Currency Board Arrangement
CEECs	Central and East European Countries
CPI	Consumer Price Index
DEM	German Mark
EC	European Community
EFF	Extended Fund Facility
EIB	European Investment Bank
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FESAL	Financial and Enterprise Structural Adjustment Loan
FRY	Federal Republic of Yugoslavia
FYROM	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
IFIs	International Financial Institutions
IMF	International Monetary Fund
MFA	Macro-Financial Assistance
NIS	New Independent States
PRGF	Poverty Reduction and Growth Facility (formerly ESAF)
SAA	Stabilisation and Association Agreement
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
USD	Dollar of the United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

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I. INTRODUCTION

This report assesses the economic situation, the progress of reforms and the prospects of the countries that benefited in 2002 from ongoing macro-financial assistance programmes with particular reference to the implementation of the economic and structural reform conditions attached to it.

Chapter II provides an overview of the EC macro-financial assistance to third countries, with an historical background, a summary of the operations in 2002, and an analysis of the burden-sharing among the international donor community.

The following chapters discuss the economic situation in the countries for which either new macro-financial assistance operations have been decided by the Council or disbursements under previously decided operations have been made or are still outstanding in 2002.

In line with the recommendations of the Court of Auditors in their special report of March 2002, particular attention is paid to the relevant aspects of the transition process and of the implementation of structural reforms in the beneficiary countries. Progress in this respect also reflects the degree to which the corresponding economic policy conditions attached to the EC macro-financial assistance have been met.

This report is submitted in accordance with the Council Decisions regarding Community macro-financial or exceptional financial assistance to third countries and follows on from the reports presented in previous years¹.

The complete list of macro-financial assistance operations decided by the Council with the corresponding disbursements up to the end of 2002 appears in Annex 1. Annex 2 summarises the macro-financial assistance provided by bilateral and multilateral donors to the countries that received EC macro-financial assistance. Finally, selected macroeconomic indicators of the beneficiary countries are presented in Annex 3.

1 See the following Communications from the Commission to the Council and the European Parliament with the title 'Report on the implementation of macro-financial assistance to third countries':
COM(1992)400 of 16 September 1992
COM(1994)229 of 7 June 1994
COM(1995)572 of 27 November 1995
COM(1996)695 of 8 January 1997
COM(1998)3 of 13 January 1998
COM(1999)580 of 15 November 1999.
COM(2000)682 of 27 October 2000.
COM(2001)288 of 1 June 2001.
COM(2002)352 of 11 July 2002

II. OVERVIEW

1. Background

Macro-financial assistance (MFA) supports the political and economic reform efforts of the beneficiary countries and is implemented in association with support programmes from the IMF and the World Bank. It has continued to incorporate a set of principles reaffirmed by the Council in their conclusions of 8 October 2002 which underline the exceptional character of this assistance, its complementarity to financing from the IFIs and its macroeconomic conditionality. In particular, Community MFA has supported efforts by recipient countries to bring about economic reforms and structural changes. In close co-ordination with the IMF and the World Bank, it has promoted policies that are tailored to specific country needs with the overall objective of stabilising the financial situation and establishing market-oriented economies. The Commission implements this type of assistance in consultation with the Economic and Financial Committee.

2. Macro-financial assistance in 2002

A) New decisions

New decisions of the Council on granting MFA totalled EUR 315 million in 2002, excluding reformatting of two undisbursed loan operations (see hereafter point b.). When taking into account these reshaped operations, new **net** commitments during the year are reduced to EUR 208 million.

The years 2000 and 2001 had already been years of enhanced MFA to the Balkan countries, where six operations (including two amendments of previous decisions) for a maximum amount of EUR 448 million had been decided by the Council for the former Yugoslav Republic of Macedonia, Kosovo, Montenegro and the then FRY. In 2002, this increased assistance to the Balkan region was confirmed by substantial MFA packages for, respectively, Serbia and Montenegro and Bosnia Herzegovina.

- a. The Council decided on 5 November 2002 to provide a second macro-financial assistance to Serbia and Montenegro of up to EUR 130 million comprising a loan element of up to EUR 55 million and a grant component of up to EUR 75 million. On the same day, the Council approved a second assistance package of up to EUR 60 million to Bosnia Herzegovina made up of a loan of up to EUR 20 million and a grant of up to EUR 40 million.
- b. Regarding the NIS, the accent was put on reformatting undisbursed previous macro-financial assistance operations. First, the 1998 Decision of the Council granting a loan of up to EUR 150 million to Ukraine, of which only EUR 58 million were eventually disbursed, was replaced by a new EUR 110 million loan package decided in July 2002, while the EUR 92 million undisbursed part of the previous loan was cancelled. The new loan includes more favourable terms, both in maturity (15 years instead of 10) and in grace period (10 years instead of 7). In the same vein, the EUR 15 million balance of payments loan decided in 2000 for Moldova was cancelled and replaced by a grant of the same amount approved by the Council in December 2002.

B) Disbursements

Disbursements of macro-financial assistance amounted to a total of EUR 141 million excluding grants of EUR 7 million for Tajikistan and of EUR 15 million for Bosnia disbursed on the basis of procedures initiated in 2002 but finalised in early 2003. The disbursements consisted of EUR 11 million for Armenia, EUR 15 million for Kosovo and EUR 115 million for Serbia and Montenegro (the then FRY). All these disbursements took the form of grants.

C) Repayments and undisbursed operations

Some MFA operations decided in the first half of the 1990s have not been fully paid out as initially foreseen. This has been the result of either improved external financial conditions (Hungary, Baltics, Slovakia, Algeria), or of a difficult economic or political climate (Albania, Belarus). In these cases, the disbursement of the remaining tranches is not programmed anymore. For more recently adopted operations, implementation, in some cases, has been delayed because of a slowing-down in the reform process (Romania, Georgia). In the case of Moldova and Ukraine, evolving circumstances have led the Commission to reconsider the terms of the existing assistance operations and to reshape them in 2002 as mentioned above.

The last column of Annex 1 provides details concerning undisbursed outstanding, suspended or cancelled amounts.

3. Trends and geographical distribution of macro-financial assistance

The EC MFA is intended to support macroeconomic stabilisation of the beneficiary countries and ease their balance of payments (and budget) difficulties. It plays also a very useful role in promoting structural reform. Over the years, the number of countries to which it was appropriate for the Community to extend such support expanded, as a growing number of countries neighbouring the EU faced balance of payments difficulties and committed themselves to rigorous programmes of economic reform. This led to a change in the geographic balance of assistance from the early years, when most beneficiary countries were countries in Central and Eastern Europe. As a result of the conflicts in the Western Balkans, in particular the Kosovo conflict of 1999 and of the political changes in Serbia and Montenegro (formerly, the FRY), a clear tendency for a relative increase of MFA to the countries of the Balkans developed through the 1999-2002 Council Decisions.

The four MFA decisions taken in 2002 were for traditional balance of payment assistance operations, three of them taking the form of grants.

A specificity of the decisions of the 2000-2002 period is indeed the substantial share of grant support in the total amount decided : 44,5 % instead of 6 % over the 1990-1999 period. The new grant/loan proportion of the assistance packages reflects the assessment made by the EU bodies of the relative degree of poverty of the recipient countries and of their limited debt servicing capacity. As observed already in 2000 and 2001, MFA is aimed not only at promoting macroeconomic stabilisation but also at supporting the recipient governments' programmes of structural reform. Consistently, MFA has been effectively combined with assistance from the PHARE/ISPA, TACIS or CARDS programmes with a view to strengthening the institutional capacity that was essential to the success of the structural reform process.

Tables 1 and 2, and their accompanying Graphs 1a and 2a underline the exceptional character of the EC MFA. The highest volumes of MFA operations were decided and disbursed in the

years immediately after the changes in the political and economic systems of the countries of Central and Eastern Europe. Since then, the fluctuations in the amounts of MFA reflect decisions taken on a case-by-case basis after an assessment of the macro-economic situation and residual external financing needs of the potential beneficiary countries. Graph 1a - for **net amounts of operations** decided over the whole period from 1990 to 2002 (totalling around EUR 6 billion) - and Graph 2a - for actual amounts disbursed (totalling over EUR 4.8 billion) - show the important concentration of the assistance in the CEECs that are candidates for EU accession (around 55 % of total macro-financial assistance decided over the last 13 years). However, MFA to these countries was progressively phased out in parallel with their progress in macroeconomic adjustment and reform. More recently, MFA has been mainly provided to the Western Balkans (63,5 % of the operations decided from 1999 to 2002 and 82% for 2000-2002) and some low income NIS. The relatively low amounts for the Mediterranean countries (13 % of the overall amounts authorised, but no new authorisation since 1996) should be considered against the background of other forms of macroeconomic support made available to these countries (notably, the MEDA Structural Adjustment Facilities).

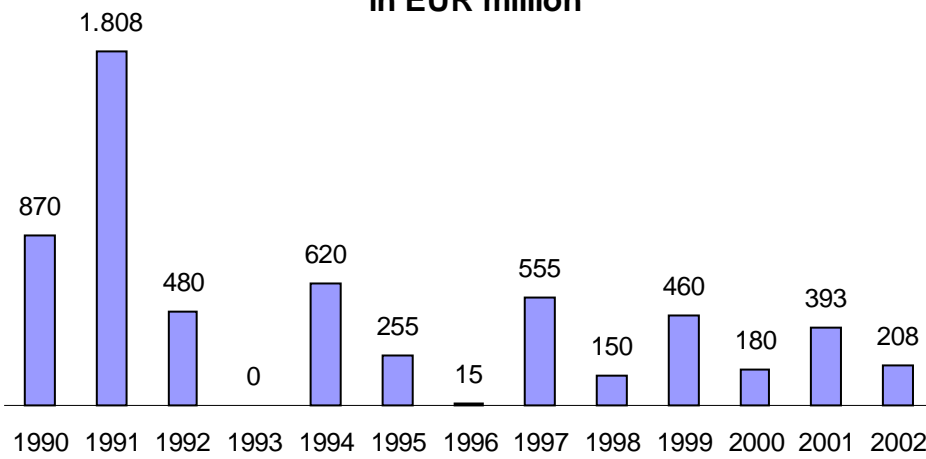
Table 1. Macro-financial assistance, 1990-2002
Maximum amounts authorised, millions euro

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
By region													
Central European Candidate Countries	870	1.220	410		255			250		300			
Western Balkans			70		35			40		160	55	393	190
NIS					130	255	15	265	150		125		18 (a)
Mediterranean		588			200								
Total amounts authorised	870	1.808	480	0	620	255	15	555	150	460	180	393	208
out of which, straight grants		28	70		35			95		70	90	168	130
											Kosovo (35)		Serbia and
											Montenegro	FYROM (18)	Montenegro
											(20)	Serbia and	(75) Bosnia
											Tajikistan	Montenegro	(40)
		Interest									Bosnia (40)	(35) Moldova	(120) Kosovo
		subsidies									FYROM (30)	(15)	(30)
		to Israel	Albania		Albania		Armenia and						Moldova (15)
							Georgia (95)						(b)

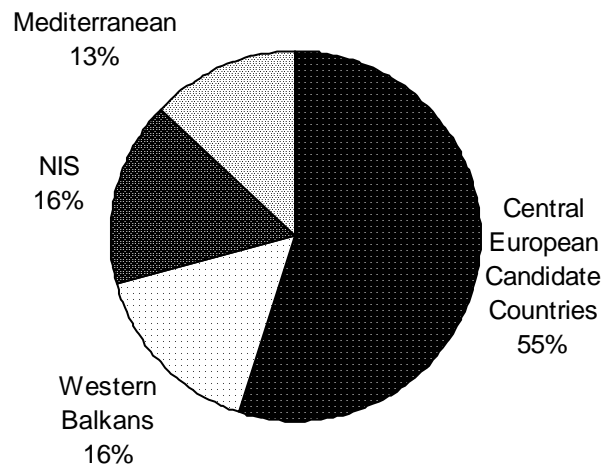
(a) net amount taking into account (b) and, for Ukraine, new loan of EUR 110 million together with simultaneous cancellation of EUR 92 million out of the EUR 150 million loan decided in 1998.

(b) grant of EUR 15 million and simultaneous cancellation of the EUR 15 million loan decided in 2000

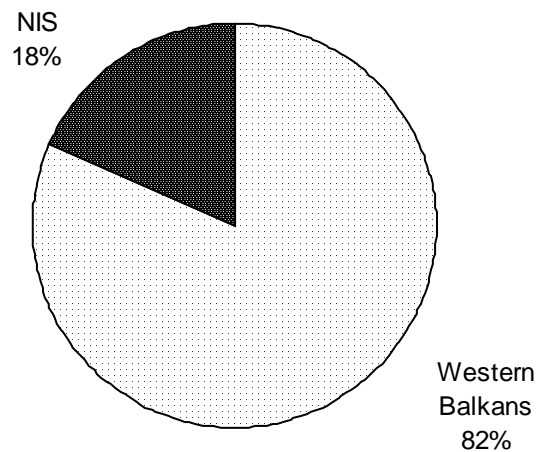
**Graph 1a. Maximum amounts authorised by year,
in EUR million**



**Graph 1b. MFA 1990-2002, authorisations
Distribution by region**



**Graph 1c. MFA 2000-2002, authorisations
Distribution by region**

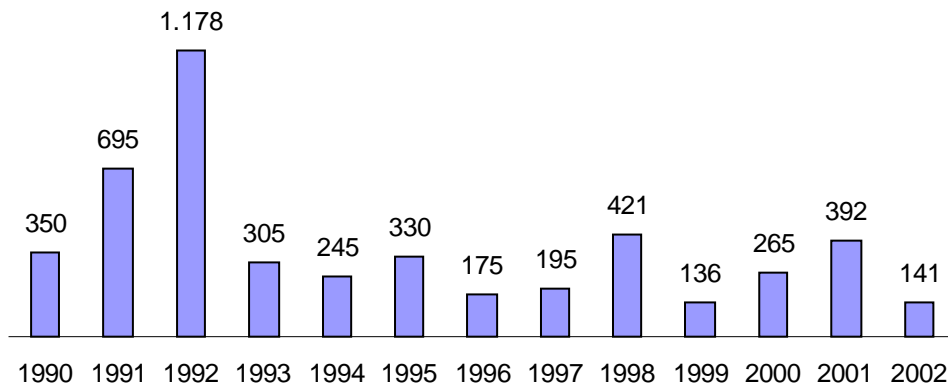


Disbursements, millions euro

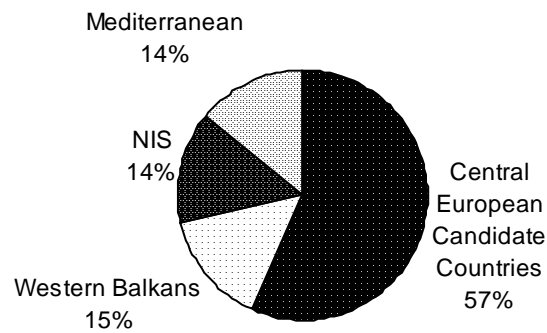
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
By region													
Central European Candidate Countries	350	695	705	270	70	80	40	70	250	40	160		
Western Balkans			35	35		15	20	25	15	25	105	312	130
NIS					25	135	115	100	156	71		80	11
Mediterranean			438		150	100							
Total amounts disbursed	350	695	1.178	305	245	330	175	195	421	136	265	392	141
out of which, straight grants			63	35		15	20		18	28	85	105	141
												Bosnia (15) FYROM (10) Kosovo (15) Serbia and Bosnia (10) Montenegro FYROM (20) (ex FRY) (35) Armenia (11) Kosovo (15) Armenia (4), Kosovo (35) Georgia (6) Serbia and Georgia (9), Montenegro Tajikistan Bosnia (15) (20) (14) Montenegro (115)	
			Israel (28) Albania (35)	Albania		Albania	Albania	Armenia (8) Georgia (10)					

NB: 2000 figures include disbursements in favour of Bosnia, FYROM and Montenegro which, for technical reasons, took place in early January 2001.
2001 figures include disbursements in favour of FYROM and Tajikistan which, for technical reasons, took place in early January 2002.

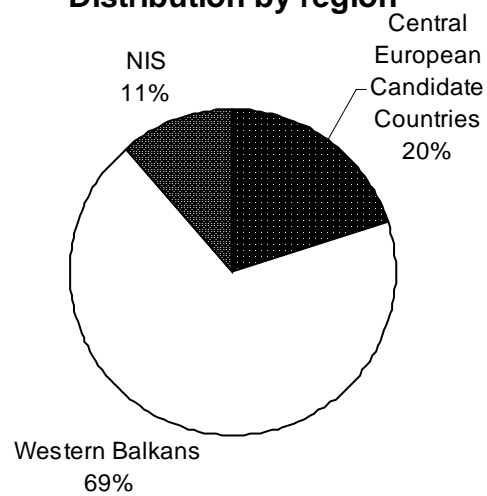
**Graph 2a. Amounts disbursed by year,
in EUR million**



**Graph 2b. MFA 1990-2002, disbursements,
Distribution by region**



**Graph 2c. MFA 2000-2002, disbursements,
Distribution by region**



4. Burden-sharing

In the context of the donor co-ordination process in support of CEECs and the Western Balkans, the European Commission in liaison with the World Bank has, where appropriate, organised pledging conferences with a view to assessing the external financing needs of the beneficiary countries and identifying potential contributions from the IFIs and bilateral donors (including the EC). A similar approach has been followed for other potential beneficiary countries through Consultative Group meetings convened at the initiative of the World Bank.

The resources provided by various donors to support the residual external financing needs of the countries that receive EC MFA are summarised in Annex 2. Details by recipient country for the year 2002 are provided in Annex 2.1.

Since the inception of MFA, the absolute amounts committed by the EC have fluctuated substantially, in parallel with the volume of financial support provided by the international community (see Annex 2 and similar tables in previous MFA reports).

Back in 1990, Community assistance was substantial in comparison with funding provided by IFIs. The Community indeed played a key role, both as a major provider of these funds and as the co-ordinator of bilateral assistance for the CEECs through the G-24 process. However, as the IFIs were progressively able to mobilise more resources through new instruments, their share in the financing packages rose substantially over the period, with the exception of years 2000 and 2001.

At the same time, contributions from external creditors, both public and private, were mobilised in the form of debt-relief and debt-reduction operations which took off in 1991 and became particularly important in 1994, 1995 and 2001. Among the countries receiving EC MFA, those concerned by these debt-relief and similar operations were Algeria in 1991 and 1994; Bulgaria in 1991, 1994 and 1997; Moldova in 1996; Ukraine in 1994, 1995 and 1999, and the former Yugoslav Republic of Macedonia, Bosnia and Herzegovina and Albania in 1999. In 2000, no debt relief took place for any country receiving EC MFA. In 2001, Serbia and Montenegro (the then Federal Republic of Yugoslavia) benefited from a substantial debt relief arrangement agreed in the context of the Paris Club. In 2002, debt relief was more limited and benefited again to Serbia and Montenegro and also Ukraine, through the Paris Club.

III. ARMENIA

1. Executive summary

The Armenian economy continued to grow at a record high rate in 2002. The preliminary GDP data give a real growth rate of 12.9% (9.6% in 2001). Strong growth in exports (+48.5%), owing mainly to the recovery of the diamond processing sector, led to an improvement in the current account deficit (estimated at 8.5% of GDP in 2002). The end-2002 consumer price inflation was 2% (3% at end-2001).

After a merger, the four electricity distribution companies were privatised in 2002 and bringing private management to the power generation sector is also under way. In November 2002, Armenia signed a debt-for-equity swap with Russia for the outstanding debt of about USD 100 million. This deal includes a transfer of ownership over a thermal power plant.

Armenia's accession to the World Trade Organisation was approved by the WTO's General Council in December 2002. On the other hand, the benefits of an open trade regime are not fully realised until the re-establishment of regional trade relations which is depending on the resolution of the Nagorno-Karabakh conflict.

A Commission staff mission concluded in July 2002 that Armenia had made substantial progress in satisfying the conditions for the disbursement of the grant tranche scheduled for 2002. The grant tranche of EUR 5.5 million was disbursed in December 2002 following the IMF's approval of the first and second reviews of the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) and after Armenia had reduced its net debtor position towards the Community.

SUMMARY STATUS OF ECONOMIC REFORM	
1. Price liberalisation	No administered prices exist outside the utilities sector.
2. Trade liberalisation	Liberal trade policy. Simple and relatively open import regime with a low tariff structure. No quantitative restrictions. Accession to the WTO approved in December 2002.
3. Exchange regime	Floating exchange rate. Limited official intervention. Access to foreign exchange unrestricted. Interbank market dominant for foreign exchange.
4. Foreign direct investment	Liberal policy towards foreign direct investment, absence of restrictions on repatriation of profits and capital. FDI inflows 3.3% of GDP in 2001.
5. Monetary policy	Low inflation environment maintained through prudent monetary policies conducted by the Central Bank of Armenia.
6. Public finances	Total fiscal revenues incl. grants estimated at around 19% of GDP in 2002, tax revenues about 15% of GDP; total expenditure estimated at about 22% of GDP.
7. Privatisation and enterprise restructuring	A three-year privatisation programme was adopted in 2001 including more than 900 enterprises. The final stage of the privatisation process has however been slower than foreseen due to lack of interest among foreign investors in a difficult business climate.
8. Financial sector reform	Minimum capital requirement for existing banks is scheduled to increase by 2005 to USD 5 million which is already applied to new banks.

2. Macroeconomic performance

The Armenian economy experienced strong growth also in the second half of the year 2002 which brought the real GDP growth rate to a record high level, estimated at 12.9% for the year as a whole (9.6% in 2001). Economic growth continued to be driven by the industrial sector (+14.2%), most importantly the diamonds processing sector but also other industrial

sectors such as metallurgy and food processing did well in 2002. There has also been a construction boom in Armenia (both housing construction and public works). In agriculture, the growth rate was only 4.4% due to poor weather conditions. In retail trade, the turnover increased by 15.6%. Consumer price inflation stayed low at 2% at end-2002 (3% at end-2001). Supported by remittances from abroad (estimated at about 4% of GDP) and a low inflation rate, the dram was fairly stable in nominal terms in 2002. In real effective terms the dram depreciated in 2001-2002 supporting significantly the competitiveness of the economy.

The Government managed to narrow the fiscal deficit last year. The central government deficit for 2002 is estimated at about 3% of GDP (further down from a deficit of 3.8% in 2001). VAT is the main factor behind the improved fiscal performance, reflecting both strong growth in domestic demand and better tax administration. VAT revenues increased by nearly 20% and accounted for 40% of fiscal revenues.

The current account deficit was narrowed further during 2002 to about 8.5% of GDP (9.5% in 2001). Exports were 48.5% higher than in 2001 and imports increased by 12.9% which narrowed the trade deficit to 20.9% of GDP (25.2% in 2001). Precious metals and stones accounted for nearly half of total exports. Foreign direct investment picked up in 2002 with a more diversified sectoral distribution than before and a stronger focus towards SMEs.

Armenia's external public and publicly guaranteed debt stock was USD 1.02 billion (about 42% of GDP) at end-December 2002. Nearly 80% of the debt is contracted on concessional terms. The NPV of the external debt stock is estimated to have decreased from 129% of exports in 2001 to about 120% in 2002. In November 2002, Armenia signed a debt-for-equity swap with Russia for the outstanding debt of about USD 100 million. The swap includes the transfer of five enterprises (including a thermal power plant) to Russia in settlement of the outstanding debt. It is projected that as a result of the swap the NPV of the external debt will be reduced to 96% of exports in 2003 when the swap takes place. Armenia is also negotiating with Turkmenistan to barter commodities for its outstanding debts. The Central Bank's gross international reserves increased in the second half of the year and were at a comfortable level at the end of the year, equivalent to 4 months of imports.

The IMF Board approved a three-year arrangement for Armenia under the Poverty Reduction and Growth Facility in May 2001. After some delays, the first two semi-annual reviews of the programme were completed in September 2002. Of the total PRGF loan amount of SDR 69 million, Armenia has drawn SDR 30 million (USD 39 million) by end-2002. The third review is scheduled in March 2003.

3. Structural reform

Armenia's accession to the WTO was approved by the WTO General Council in December 2002. The benefits of an open trade regime are not fully realised, however, because the re-establishment of regional trade relations with Azerbaijan and Turkey is pending to the resolution of the Nagorno-Karabakh conflict.

The privatisation programme for the years 2001-2003 is being implemented gradually with some larger deals such as the Nairit chemical plant, Ararat cement and the Zvartnots airport concluded with foreign investors in 2002. Following the merger of four electricity distribution companies, a majority stake of the company was sold to a foreign investor which contracted a private management company to run the Electricity Distribution Networks. The Hrazdan power generation complex will be handed over to the Russian government as part of the debt for equity swap. Russia will also take over the financial management of the Medzamor Nuclear Power Plant in 2003 in exchange for clearing the plant's debts for Russian nuclear

fuel suppliers. Privatisation or bringing of private management is under preparation for other power generation assets as well.

The Government prepared a draft Anti-Corruption Strategy in 2002 which has not been implemented yet. The EBRD has estimated on the basis of business surveys that the average “bribe tax” has decreased in Armenia from 4.2% of firms’ annual total sales in 1999 to 0.9% in 2002. According to the same survey, the share of firms which paid bribes frequently decreased from 40.3% to 14.3%.

In the banking sector, the minimum capital requirement was raised to USD 1.65 million with a view to raise it gradually to USD 5 million for all banks by 2005. In 2002 eight banks of the total 28 were under temporary administration prior to an eventual merger where possible or liquidation.

According to a census at late 2001, Armenia’s population has fallen to 3 million from 3.7 million in 1991 due to the migration of about a quarter of the population (migrants are mainly young and educated).

4. Implementation of exceptional financial assistance

Armenia has benefited from a European Community assistance package which consists of a loan of EUR 28 million (disbursed in 1998) and a total grant amount of up to EUR 30 million. The year 2001 annual grant tranche of EUR 5.5 million was disbursed in early 2002 soon after the early debt repayment of EUR 7 million was made by Armenia to the Community. A Commission staff mission concluded in July 2002 that Armenia had made substantial progress in satisfying the macroeconomic and structural conditions for the disbursement of the full amount of the 2002 grant tranche of EUR 5.5 million. Waivers were, however, granted on a couple of conditions which had not been fulfilled owing mainly to the difficult external environment which led to the failure of a number of privatisation attempts. In December 2002, Armenia made an early debt repayment of EUR 7 million to the Community as agreed. The grant tranche of EUR 5.5 was disbursed soon thereafter by the Commission. In total, EUR 23 million have been disbursed to Armenia as grants under the exceptional financial assistance in the period 1998-2002. After early debt repayments in three occasions, Armenia’s outstanding debt to the Community amounted to EUR 9 million at the end of 2002.

The Commission services also reached an agreement with the Armenian authorities on the structural conditionality for the 2003 grant tranche (up to EUR 5.5 million). The specific conditions were identified in the same areas as the year before (such as tax revenue collection, re-organisation of state-owned enterprises, energy sector reform and civil service reform) and they are consistent with policies pursued by the authorities in the context of the Poverty Reduction Strategy Paper which is under preparation.

IV. BOSNIA AND HERZEGOVINA

1. Executive summary

In the course of 2002 Bosnia and Herzegovina (BiH) maintained macro-economic stability, low inflation, and continued efforts towards improved fiscal performance. The growth rate is estimated at 4% for 2002, slightly down from 4.5% in 2001. BiH's reliance on donor assistance to finance a large share of its public deficits and a very high current account deficit is a clear source of vulnerability of the economy, also in the light of the on-going phasing out of reconstruction assistance.

In this context, both the Reform Agenda of the authorities adopted in July 2002 and the new IMF Stand-By Arrangement approved in August 2002 could provide a sound framework to achieve growth through continued reforms. These include further fiscal consolidation, completion of privatisation, and the achievement of a fully functioning single economic space, all of which would allow BiH to turn a currently aid-dependent economy into one driven by SME development, FDI and exports. This however requires a revival of the momentum of reforms, which are currently hampered by institutional and political divisions.

Within this new framework, agreed with the IMF, the Council decided on 5 November 2002 to provide BiH with further macro-financial assistance of up to EUR 60 million, (up to EUR 20 million loan and 40 million grant). Given the positive outcome of the first IMF Review, the Commission launched disbursement procedures in December 2002, which will lead to the payment of the first tranche of a EUR 15 million grant in the first quarter of 2003.

SUMMARY STATUS OF ECONOMIC REFORM	
1. Price liberalisation	Most prices have been liberalised with the exception of a few selected public services.
2. Trade liberalisation	After the Free Trade Agreement (FTA) with Croatia, which became effective on 1 January 2001, similar FTAs were signed in 2002 with FYROM and Serbia and Montenegro. Accession to the WTO is moving ahead and is now expected for 2003.
3. Exchange regime	Since June 1998 BiH has established a Currency Board Arrangement; the common currency, the KM, is pegged to the Euro at the fixed rate of 1.96 KM.
4. Foreign direct investment	Some actions have been undertaken to improve the business environment: a Foreign Investment Promotion Agency (FIPA) was created, while Entities have harmonised their Foreign Investment Laws. However, the environment remains uncertain for foreign investors, with a perception of high risk and non-transparent policies.
5. Monetary policy	The Central Bank of BiH is responsible for operating the Currency Board Arrangement. The CBBH and other banks are prohibited from lending money to the government.
6. Public finances	The size of the government in BiH is relatively high, with public spending at around 56% of GDP, coupled with corruption problems and poor quality of the public services. However, significant fiscal consolidation has been achieved over time, together with tax harmonisation between entities. Entities now have the same customs rates and VAT introduction is being considered.
7. Privatisation and enterprise restructuring	While the privatisation of small and medium enterprises is virtually complete in both Entities, progress on the sale of large-scale 'strategic' enterprises, which could attract foreign investors, has lagged behind.
8. Financial sector reform	Progress in bank privatisation has been encouraging and foreign capital in the banking sector is significant. Adequate banking regulations including supervision rules and prudential regulations have been established, e.g. increased minimum capital requirements. Early in 2002 stock exchanges opened in Banja Luka and Sarajevo, and a State Deposit Insurance Agency has been created from the two Entity agencies in August 2002.

2. Macroeconomic performance

Currently available indicators suggest a fall in annual GDP growth over the recent years. After high rates in the first half of the '90s fuelled by aid, the growth rate has moved down from 5.6% in 2000, to 4.5% in 2001, and is estimated to have been at 4% for 2002. According to official data, between January and September 2002 industrial output in the Federation of

BiH (FBiH) rose by 7.5% compared to the same period in 2001. In the Republika Srpska (RS), industrial production continued to fall in 2002, although at a smaller pace, with first three quarters' data showing a decline of 7%. The official unemployment rate in 2002 was around 41% in FBiH and 40% in the RS. It should be noted, however, that official unemployment statistics may be misleading, given the large but undisclosed number of people in the grey economy, working in informal markets of goods and services. World Bank unofficial estimates suggest in fact that the actual rate is one half of the official figure.

Due to the continued adherence to the currency board arrangement, inflation has remained subdued. In the first nine months of 2002 inflation was roughly zero in FBiH, and 2% in the RS. With the Convertible Mark (KM) pegged to the Euro at the same rate since the introduction of the EU currency in January 1999, the exchange rate of the KM remains stable. The net international reserves of the Central Bank of BiH amounted to EUR 54 million at the end of 2002, an increase of 40% compared to the end of 2001, reflecting the conversion into KM of previously unrecorded DM following the introduction of Euro notes and coins in the 12 EU countries.

Fiscal performance has improved, although the size of the government remains large, with public spending at around 56% of GDP. The efforts initiated in 2001 to reduce the high general government deficit were pursued in 2002. The authorities aimed at a consolidated budget deficit of 11.5% (5.5% after grants), and driven by the expenditure side of the budget, made cuts in pensions but also in investment spending which lower grant financing made necessary. However, given the better revenue performance, the estimated consolidated budget deficit has been revised downwards at 9.4% of GDP (4% after grants).

On the external side, the balance of payments continues to show deficits, both on current account and trade account. The current account deficit remains very high and (excluding official transfers) amounted in 2002 to 21% of GDP, a slight decrease from the recorded 23% of 2001. The efforts to reduce barriers to FDI have continued in 2002, when net FDI is estimated to have increased to EUR 260 million, compared with EUR 145 million in 2001. External debt reached 52% of GDP at the end of 2002 and is expected to remain at this level over the medium-term. The ratio of debt service to exports has started to pick up (8.3% in 2002).

3. Structural reforms

BiH's public finances have improved at Entity level through better enforcement of revenue collection and the implementation of newly established Treasury systems. Moreover, Entities have taken steps to downsize the public sector, notably by reducing the level of military staff.

In the areas of customs and tax reforms, inter-entity harmonisation continues, with double taxation on inter-Entity trade ending in July 2002.

The restructuring of tax and customs administrations is also underway in both Entities, under the pressure of the international community. Attention has focused recently on the introduction of state-level VAT and the unification of the Entity-based customs administration, both of which would support public finances, better fund existing and new State institutions and promote sustainability of the current fiscal stance. However, some resistance can be expected at the Entity level, notably given that some of these changes may entail rationalisation in employment, reduce the scope for tax evasion, and increase the role of the State in tax collection.

Privatisation performance has been disappointingly slow in both Entities. Delays have been partly due to overoptimistic expectations of the authorities on the market value of enterprises,

but also because of the lack of current information on enterprise debts. While the privatisation of small and medium enterprises is virtually complete in both Entities, progress on the sale of “strategic” enterprises, which could attract foreign investors, has lagged behind. In the Federation, within the 56 ‘strategic companies’ prepared for privatisation with the help of the international community (e.g. USAid, WB, EC), five were privatised in 2002, compared to six in 2001. Tenders have been launched for another 28. In the RS, from a list of 80 companies, only one has been sold in 2002 (three in 2001) with tenders launched for another 23.

In July 2002 Entity and State governments agreed with the international community a Reform Agenda for the Economy (“Jobs and Justice”). The reforms are designed to support the development of a competitive market economy and to facilitate private investment. By the end of 2002 some actions had been undertaken in improving the business environment: a Foreign Investment Promotion Agency (FIPA) was created, although it is not yet operational, while Entities have harmonised their Foreign Investment Laws; in September a new bankruptcy law was passed. The authorities also sought to improve this environment by facilitating both entry and exit of firms, and by lowering administrative costs.

The target of privatising all banks by the end of 2002 was achieved in the RS, but not yet in the FBiH. Recent progress has been encouraging and foreign capital in the banking sector is significant. A State Deposit Insurance Agency has been created from the two Entity agencies in August 2002. Adequate banking regulations including supervision rules and prudential regulations have been established, although responsibility for this remains with the Entities rather than with the Central Bank. In this context, progress is also being achieved on moving towards a single banking sector regulator, with legislation being harmonised. Early in 2002 stock exchanges opened in Banja Luka and Sarajevo, but market capitalisation is still insignificant.

4. Implementation of macro-financial assistance

In May 1999, the Council decided to provide BiH with community macro-financial assistance comprising a loan facility of up to EUR 20 million and a grant facility of up to EUR 40 million (Decision 1999/325/EC), in the context of an IMF programme (three-year stand by arrangement) agreed in May 1998. The implementation of this first macro-financial assistance operation was concluded in December 2001, when the third grant tranche of EUR 15 million was disbursed.

Based on a European Commission proposal of 31 July 2002, the Council approved on 5 November 2002 (Decision 2002/883/EC) further Community macro-financial assistance of up to EUR 60 million to BiH, comprising a loan element of up to EUR 20 million and a grant element of up to EUR 40 million. This assistance was provided in support of a comprehensive economic and structural adjustment programme in the context of an IMF Stand-by arrangement approved in August 2002. Like the first package, the implementation of this assistance is linked to progress with specific economic policy conditions.

A Commission staff mission to BiH took place in mid-November, and a Memorandum of Understanding (MoU) was agreed with the authorities in early December. The MoU includes undertakings from the BiH authorities to progress with reforms in the areas of public finance and administration, financial sector, and private sector development and the business environment. Following the positive outcome of the first IMF Review, the EC launched in December 2002 the payment of the first tranche of EUR 15 million grant. Out of this amount, 25% was made available directly to the State (EUR 3.75 million), while the remainder was allocated on a one third-two thirds basis between the RS and FBiH respectively, as in the case of the previous MFA operation.

V. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

1. Executive summary

In 2002, the economic performance of the former Yugoslav Republic of Macedonia (fYRoM) has been below expectations. The resumption in growth has been weak (+0.3% against more positive initial forecasts of 3-4%). The general government deficit (5.9% of GDP) went well beyond initial forecasts (3%) and marginally improved compared to 2001. The trade deficit widened by more than 40%, reaching 23% of GDP. On the positive side, monetary and exchange rate stability was maintained.

The structural reform process slowed down in 2002 because of the September general elections and the subsequent change of government. Limited progress was recorded in implementing structural reforms in a number of areas, notably large scale privatisation, strengthening budget controls, and public administration. The 6-month IMF Staff Monitored Programme, which started on 1 January 2002, went off-track in Spring after the authorities took expansionary fiscal measures. In November 2002, the new Government resumed talks with the IMF on a new stand-by arrangement, which will provide macro-economic stability to the country.

In November 1999, the Council approved a EUR 80 million (loan up to EUR 50 million and grant up to EUR 30 million) macro-financial assistance in favour of the fYRoM, which it increased with a EUR 18 million grant in December 2001. In January 2002, the second tranche (EUR 10 million grant and EUR 12 million loan) was disbursed. In September, the Commission and the fYRoM authorities signed a Supplemental Memorandum of Understanding setting the conditions for the disbursement of the outstanding assistance (EUR 46 million).

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Price liberalisation has been essentially completed, except for most utilities and various items such as oil and oil by-products.

2. Trade liberalisation

The Interim Agreement on trade and trade-related matters with the EC, which entered into force in June 2001 after the signature of the Stabilisation and Association Agreement, implies more liberal market access for EU products and gradual reduction of tariffs on most important products. Negotiations for accession to the WTO were concluded in September 2002, with full WTO membership expected by Spring 2003. In 2002, the country completed the network of free trade agreements with neighbouring countries promoted by the Stability Pact.

3. Exchange regime

From early 1994, de facto peg of the denar to the DM, and since the 1st of January 2002 to the euro. Since the devaluation of July 1997, the denar stands at an equivalent of some 61 denar to one euro.

4. Foreign direct investment (FDI)

Approval from the government is still requested to carry out some types of foreign direct investments, while the absence of a properly functioning market for land is also hampering the FDI inflows. FDI inflows have been erratic in recent years and largely dependent on a few large transactions.

5. Monetary policy

The central bank is independent from the government by law. Central bank lending to the government is not allowed, except for non-renewable one-day loans. Monetary policy is oriented towards price stability, the main statutory objective. The exchange rate anchor is the intermediate target of the central bank.

6. Public finances

VAT was introduced in April 2000 and represents a significant source of revenue. The temporary Financial Transaction Tax, which was introduced in 2001, was extended until the end of 2002. A single Treasury account within the Ministry of Finance is in place, identifying all budget users, as well as a system of internal auditing are being introduced but are not fully operational.

7. Privatisation and enterprise restructuring

The privatisation programme begun in 1993. By the end of December 2002, some 1684 small and medium size enterprises had already been privatised, while 84 state companies were left for sale. Privatisation in the agricultural sector is nearly complete. Firms and organisations conducting activities of special national interest, public services and utilities are not part of the programme. In 2001, the national telecom operator was sold to the Hungarian company Matav. The liquidation of the remaining 24 large loss-making companies, out of an initial list of 40 firms, has been delayed.

8. Financial sector reform

The banking law of 2000 established the legal framework for modernised and strengthened banking sector. The banking sector is largely privatised and highly concentrated, with the three largest banks having a combined market share of 65%.

2. Macroeconomic performance

In 2002, the economic performance of the former Yugoslav Republic of Macedonia has been below expectations. Several factors such as the persistence of the negative effects of the 2001 crisis, the weak external environment, the political uncertainty surrounding the general elections in September and the lack of an IMF agreement had a negative impact on the economic and business climate. GDP, which had previously been expected to grow at a rate of about 3-4%, posted a slight increase by 0.3%. The contraction in industrial production by some 5% was compensated by positive growth in agriculture (+2%) and the service sector (+4%). The level of officially registered unemployment increased to around 32% of the labour force, from 30.5% in the previous year. However, taking into account the informal sector, real unemployment figures are probably lower than official data.

A tight monetary policy and the preservation of the exchange rate external anchor contributed to maintain inflation under control in 2002 and consumer prices increased by less than 3% on average. During 2002, the weighted (for different maturities) interest rate on central bank bills sold on auction increased from 13.6% in January to more than 15% in December, implying a high real interest rate of around 12% by year-end. The Macedonian Denar (MKD) remains de-facto pegged to the euro – at around MKD 61 per euro.

In 2002, fiscal performance improved, but not by as much as planned at the beginning of the year. The general government deficit reached around 5.9% of GDP, well beyond the initial forecast of 3% and slightly below the 6.2% deficit which was recorded in 2001. The worse than expected outcome was due to the negative impact of some pre-electoral spending decisions, such as the increase by 10% on average in public sector wages introduced in June and the decision to reimburse depositors who lost their savings in the 1997 TAT pyramid scheme.

On the external side, an unexpected drop in exports by around 4%, down to about USD 1100 million, against an increase in imports by 10%, up to a level of USD 1850 million, provoked a widening of the trade deficit by more than 40%, to USD 750 million, equivalent to 23% of GDP. Owing to large official and private transfers, the 2002 current account deficit (more than USD 300 million or 8.7% of GDP) is significantly lower than the trade deficit. Hard currency reserves slightly declined to about USD 700 million at the end of the year, equivalent to 4-5 months of imports. Foreign debt remained sustainable, around 42% of GDP in 2002. The former Yugoslav Republic of Macedonia was on track in meeting its debt servicing obligations.

The 6-month IMF Staff Monitored Programme, which started on 1 January 2002, went off-track during its review in Spring, following the above mentioned pre-electoral spending decisions. In November 2002, the new Government resumed talks with the IMF and, in February 2003, reached an agreement on a new stand-by arrangement, which is expected to provide improved macro-economic stability to the country. The macroeconomic framework agreed for 2003 foresees real GDP growth of 3% and an inflation rate of 3%. A target for the general government deficit of 2% of GDP (1.6% at the central level) was agreed, which if the programme remains on track will represent a significant fiscal adjustment of almost 4% of GDP with respect to the previous year.

3. Structural reforms

Price liberalisation is now essentially completed, except for most utilities, and various items such as oil and oil by-products.

The privatisation process of small and medium size enterprises, is almost concluded. By the end of December 2002, 1,688 enterprises had been privatised while 84 state companies were left for sale among those included in the privatisation programme which began in 1993. Only 10 companies were privatised in 2002, of which 5 were on the original list. The 84 remaining companies represent less than 5% of the workforce and less than 2% of the equities of the state enterprises on the privatisation list. The process of restructuring, sale or liquidation of several large loss-making public enterprises, which were identified by the 2000 government Action Plan, was suspended before its completion in the last quarter of 2002 because of the September general elections. However, some important progress was made in 2002. In September, Jugohrom - a large metallurgical company that used to employ almost 2 000 people and posted the largest loss among all the 40 firms covered by the Action Plan – was sold to the French company SCMM.

The fYRoM was the first country to sign a Stabilisation and Association Agreement (SAA) with the EC in April 2001, followed by the entry into force of the Interim Agreement on trade and trade-related matters in June 2001. During the year, the fYRoM signed Free Trade Agreements (FTAs) with Albania, Bosnia and Herzegovina and Romania, fully meeting its obligations related to regional trade liberalisation under the Stability Pact. In September, the Working Party on the accession of the fYRoM to the WTO completed the negotiations, removing the remaining obstacles to the participation of the country to the WTO in Spring 2003.

In 2002, limited progress was made in the reform of the public administration and in the area of public expenditure management; the process slowed down because of the general elections and the change of government, and is now expected to resume in 2003. The main challenge in the area of fiscal reform remains the development of decentralised government. In January 2002, the parliament adopted a Law on Local Self-Government which defines a broad set of municipal responsibilities. However, the implementation of this law crucially depends on the adoption of a new Law on Local Government Financing, which will establish the share of fiscal resources that local governments may manage and retain.

The banking sector is largely privatised and highly concentrated, with the three largest banks having a combined market share of 65%. The sector continues to suffer from structural problems such as lack of lending activity, resulting in a high liquidity situation – the capital adequacy ratio is equal to 26%, according to the latest information. High spreads between lending and deposit rates – around 9% in 2002 – are a clear indication that the banking system is not competitive enough, while the volume of bad loans – around 20% of credit exposure, according to the latest methodology – remains relatively high. However, confidence in the banking sector has been steadily increasing thanks to the monetary stability.

4. Implementation of macro-financial assistance

On 8 November 1999, the Council decided to provide the former Yugoslav Republic of Macedonia with a second macro-financial assistance of up to EUR 80 million (loan up to EUR 50 million and grant up to EUR 30 million).

This Council decision was revised on 10 December 2001, allowing for the extension of the assistance until the end of 2003 and increasing the grant element by EUR 18 million (to a grant total of EUR 48 million out of a total EUR 98 million).

A first tranche of EUR 30 million (EUR 20 million grant and EUR 10 million loan) had already been released in December 2000/January 2001. In January 2002, a second tranche of EUR 22 million (including EUR 10 million grant) was disbursed, exceptionally on the basis

of an IMF Staff Monitored Programme, taking into account the difficult political and economic situation in the country in the aftermath of the Spring 2001 ethnic conflict.

The EC macro-financial assistance is part of a package of financial support to the fYRoM of EUR 309 million, which included EUR 172 million for balance of payment support and was pledged by the international community at the March 2002 donor conference.

The conditions for the disbursement of the remaining macro-financial assistance (EUR 46 million) have been set out in a Supplemental Memorandum of Understanding (SMoU) between the European Community and the fYRoM authorities signed in September 2002. It specifies that the release of the third tranche (EUR 10 million loan and EUR 10 million grant) will be made after the approval by the IMF Board of a new arrangement with the fYRoM authorities. It also specifies the economic policy conditions attached to the release of the fourth and last tranche (up to EUR 18 million loan and up to EUR 8 million grant). They focus on progress in the areas of public administration reform, public expenditure management and fiscal reform, enterprise restructuring and private sector development, and financial sector reform.

VI. GEORGIA

1. Executive summary

Economic growth accelerated in 2002 driven by agriculture, transport and construction. Preliminary figures give a real GDP growth rate of 5.4% (4.5% in 2001). Consumer price inflation was 5.6% (5% at end-2001). The current account deficit is estimated to have remained unchanged from 2001 at about 6.5% of GDP due to modest growth in exports.

Notwithstanding the Paris Club agreement with bilateral creditors in 2001, the debt service obligations on Georgia's external debt remain high in 2003 and 2004 and Georgia is expected to seek an extension to the current rescheduling agreement.

There was little progress in structural reform in 2002. The difficult investment climate in the country was aggravated further by deterioration of the security situation.

The second review under Georgia's three-year arrangement with the IMF under the PRGF was completed in July 2002 after a delay due to the need to take additional measures to underpin fiscal revenues in the 2002 budget.

Due to lack of progress in a number of areas in the structural conditionality, a Commission staff mission proposed in December 2002 a reduced grant tranche (EUR 6.5 million) under the exceptional financial assistance to Georgia. The disbursement of the tranche is, however, pending the completion of the third review by the IMF and an early principal repayment of EUR 9 million to the Community by Georgia.

SUMMARY STATUS OF ECONOMIC REFORM	
1. Price liberalisation	Most prices have been liberalised.
2. Trade liberalisation	Liberal international trade policy. Georgia became a member of the WTO in June 2000. Most import and export restrictions have been eliminated, but recently there have been some temporary export bans motivated by theft prevention.
3. Exchange regime	The lari is not subject to exchange restrictions. Floating exchange rate.
4. Foreign direct investment	Adequate overall legislation. Unlimited repatriation of capital and profits and no limitations on holding foreign currency bank accounts. FDI inflows were 3.2% of GDP in 2001.
5. Monetary policy	The prudent monetary policy has contributed to the stabilisation of the inflation rate at a low level. Dollarisation of the economy remains high (about 80 percent of deposits are in foreign currencies).
6. Public finances	Total fiscal revenues (including grants) estimated at 16 % of GDP in 2002, tax revenues at 14.5%; total expenditure and net lending estimated at 18% of GDP. A new budget system law has been submitted to the parliament.
7. Privatisation and enterprise restructuring	Small and medium size privatisation has been largely completed. Currently the focus is on main utilities (telecommunications and the power sector) where the government aims at finding strategic investors or bringing companies under private management. There has been a marked decline in foreign investor interest due to poor business climate.
8. Financial sector reform	Several measures have been taken to strengthen bank regulation and supervision in recent years. Legislation has been amended to establish the authority of the National Bank of Georgia to revoke bank licences. The minimum capital requirement has been increased. IAS reporting standards and new asset classification and provisioning regulations have been adopted for commercial banks. Public confidence in the banking sector still remains low, however.

2. Macroeconomic performance

Preliminary data for the year 2002 show an increase in real GDP growth from 4.5% in 2001 to 5.4%. Economic growth was driven by agriculture, transport and construction. Despite poor weather conditions in parts of the country, agricultural production increased by 7%. Better energy supply with less disruptions in transmission contributed to a rebound in industrial production (+4.9%) after a decline in 2001. Consumer price inflation was 5.6% at end-2002 (5% at end-2001). The lari remained fairly stable in 2002 in nominal terms, supported by remittances from abroad.

The Government has taken some measures to improve revenue collection, and it has been able to reduce the stock of expenditure arrears while an overall expenditure restraint has been maintained. The year 2002 budget aims at an increase in the tax-to-GDP ratio for the general government from 14 ¼ % in 2001 to 14 ¾ % , reducing thereby the general government deficit further from 2% of GDP in 2001 to about 1.5% .

Georgia's trade balance deteriorated during 2002. Exports increased only by 1.5% while imports went up 6.1% (imports consist mainly of oil and oil products and natural gas). In December 2001, the Parliament introduced a ban on the export of non-ferrous scrap metal (main export item of the country) as an attempt to prevent theft. The export ban was lifted in June 2002 under pressure from IFIs. Export revenues failed to recover sufficiently in the second half of the year, however. Georgia's current account deficit is estimated to have remained unchanged from 6 ½ % registered in 2001 (excluding transfers the deficit would be 10 ½ %). An agreement was reached in December 2002 on the construction of the Baku-Tbilisi-Ceyhan oil pipeline and a parallel gas pipeline from Azerbaijan to Turkey through Georgia. Therefore, foreign direct investment will increase from 2003 to about 12% of GDP while in 2002 FDI is estimated to have stagnated at the level of 2001, at about 3% of GDP.

Georgia's public and publicly guaranteed external debt stock is about USD 1.7 billion (about 51% of GDP), and its net present value currently amounts to over 300% of central government revenues. Because of the projected increase in the external debt service from 2003 onwards, Georgia is expected to seek an additional rescheduling of its bilateral debts. The National Bank's gross international reserves increased during 2002, amounting currently to the equivalent of 1.7 months of imports.

Georgia's three-year arrangement under the PRGF was approved by the IMF Board in January 2001. The second review under the arrangement was completed in July 2002 after a delay due to the need to take additional measures to underpin fiscal revenues in the 2002 budget. By end-2002 Georgia was able to draw SDR 49.5 million (USD 66 million) of the total amount of SDR 108 million (USD 144 million) available to Georgia under PRGF.

3. Structural reforms

Georgia has a liberal trade regime but export bans, motivated by theft prevention, have been imposed over the last couple of years on timber and scrap metal. The ban on the export of scrap metal was lifted in June 2002, six months after its introduction by the Parliament. During 2002 further steps were taken towards the realisation of the Baku-Tbilisi-Ceyhen oil pipeline and the parallel Baku-Tbilisi-Erzurum gas pipeline which are expected to be in operation from 2004-2005 onwards.

Owing to the difficult investment climate in the country, progress in large scale privatisation has been overall slow. Following several failures in privatisation attempts in 2001 there was a little more activity during 2002. These included the privatisation of the Azoti chemical plant and a locomotives production plant. In the electricity sector, private management companies were introduced during 2002 both in the wholesale market and in transmission and dispatch. Remaining state-owned distribution companies were merged and bringing the merged company (United Distribution Company) under private management is under preparation. The collection rates have been improved but the sustainability of the sector is not secured yet. There has also been progress with bringing private management to the Tbilisi water company. On the other hand, the future of the telecommunications sector and the Tbilisi gas distribution is not yet settled.

Based on the Government's anti-corruption strategy, several measures are under preparation in the areas of reorganisation of public service and of financial management of the state

resources but the implementation record is still weak. The EBRD has estimated on the basis of business surveys that the average “bribe tax” has decreased in Georgia from 3.5% of firms’ annual total sales in 1999 to 2.7% in 2002. According to the same survey, the share of firms which paid bribes frequently increased however from 36.8% to 37.8%.

The number of banks is still high in Georgia in relation to the size of the economy (26 at end-2002). In 2002, the central bank adopted an analytical framework for resolution of distressed banks. A bill on money laundering was submitted to the Parliament at the end of the year.

An Economic Development and Poverty Reduction Programme (formerly Poverty Reduction Strategy Paper) was under preparation during 2002 with broad civil society participation. The document recognises among other things the significance of agricultural policies and rural development in general for poverty reduction and the challenges facing the social security systems. Strengthening governance and administrative capacity are key to the implementation of the proposed strategy.

4. Implementation of exceptional financial assistance

Substantial progress was made in many areas of structural reform during 2002, although in a number of areas, progress was lagging, in particular in fiscal policies, privatisation and energy sector reform. Therefore, a Commission staff mission in December 2002 proposed a reduced grant tranche of EUR 6.5 million for the year 2002 (the maximum annual tranche is EUR 11.5 million). The disbursement of the tranche is, however, pending the completion of the third review by the IMF under Georgia’s three-year PRGF arrangement and an early principal repayment of EUR 9 million to the Community by Georgia. In total, EUR 25 million have been disbursed to Georgia as grants under the exceptional financial assistance in the period 1998-2002. After two early debt repayments on the loan of EUR 110 million disbursed in 1998, Georgia’s outstanding debt to the Community amounted to EUR 92 million at the end of 2002. The Commission services also reached an agreement with the Georgian authorities on the structural conditionality for the 2003 grant tranche (up to a maximum of EUR 11.5 million). The specific conditions were identified in the same areas as the year before (such as tax revenue collection, energy sector reform and financial sector reform) and they are consistent with policies pursued by the authorities in the context of the Economic Development and Poverty Reduction Programme which is under preparation.

VII. MOLDOVA

1. Executive summary

Real economic growth accelerated further in 2002 to 7.2% year-on-year from 6.1% in 2001. Strong industrial production continues to drive the economy's expansion, spurred by gradual growth in exports and rising domestic demand.

The trade deficit narrowed slightly from 24% last year to 19% of GDP in 2002, while the current account gap improved at around 6% of GDP. Consumer prices rose by just 4.4% in the year to December 2002, down from 8% a year earlier.

Although structural reforms have been accelerated in recent years, transformation to a market economy is far from complete. While land reform is almost completed, the government has only recently started with the privatisation of its key economic sectors, which is severely complicated by the country's unfavourable business climate.

Fiscal policy has remained tight, but deteriorated, as the government has struggled with the heavy burden of servicing its debts, presently amounting to over 110% of GDP. Dependence on capital flows from multilateral and bilateral creditors remains therefore very high.

A combination of these fiscal and balance of payments problems in 2002 prompted the government to restructure its sole Eurobond, issued in 1997 at a maturity of five years and a face value of USD 75 million. After an early buying back in total USD 35.6 million, USD 39.4 million was transferred into a seven years amortising bond.

Moldova received no EC-macro-financial assistance in 2002. The loan of EUR 15 million, which was approved in July 2000 was replaced by a straight grant in December 2002 (2002/14307/EC). The latter Council decision opens the prospects for a new operation still to be decided.

SUMMARY STATUS OF ECONOMIC REFORM	
1. Price liberalisation	Most prices have been liberalised
2. Trade liberalisation	Liberal international trade policy. Moldova became a member of the WTO in June 2001.
3. Exchange regime	The lei is convertible for current account operations. Floating exchange rate.
4. Foreign direct investment	Unlimited repatriation of capital and profits and no limitations on holding foreign currency bank accounts. Adequate overall legislation, but implementation is often problematic, which weakens the business climate. FDI remains modest, even by regional standards.
5. Monetary policy	In spite of rapidly rising domestic demand, prudent monetary policies conducted by the National Bank of Moldova resulted in a dramatic fall in inflation.
6. Public finances	The government has been attempting to increase budget revenues and strengthen fiscal discipline. Tax collection has improved, but customs reform remains a priority. In 2002, a primary budget surplus of 2% of GDP was recorded. However, due to the heavy debt servicing burden, the overall budget deficit was 1.3% of GDP. Debt remains amounts to about 110% of GDP.
7. Privatisation and enterprise restructuring	Structural reforms have been accelerated, but transformation to a market economy is far from complete. Privatisation of the key economic sectors were delayed by a bad market sentiment.
8. Financial sector reform	The financial sector is in a relatively good shape, but further strengthening is crucial to mobilize savings and promote investment.

2. Macroeconomic performance

Moldova's economic recovery has continued from last year, with real GDP up by 7.2% year-on-year in 2002. Strong industrial growth (over 11% y-o-y) continues to drive expansion, spurred by continued import demand in traditional former Soviet markets and rising domestic demand.

By mid-2002, inflation fell to below 5% year on year for the first time since the 1998 financial crisis. Following recent progress on debt restructuring and the expected resumption of multilateral financing, the central bank is expected to maintain a broadly tight monetary stance, and a sharp increase in inflation is not expected.

The government's fiscal policy has remained generally prudent. However, revenue was weak during 2002 mainly as a result of repeated failures in key privatisation projects and a decrease of the profit tax. Continued revenue problems have forced the government to rely on sequestration and spending restraint to contain its deficit, which amounted to 1.3% of GDP in 2002.

Moldova's total external debt stands presently at around 110% of GDP. Due to the substantial structural current account deficits, which have stabilised in previous years at around 9% of GDP, the country remains highly dependent on additional support from the IFIs and bilateral donors, as long as FDI-inflows remained modest. Indeed, the large official transfers (primarily technical aid and humanitarian assistance), and a high level of remittances from abroad can only partly mitigate the chronically high merchandise trade deficit, which amounted to almost 20% of GDP in 2002.

As expected, the government's large debt-servicing hump in 2002 has forced it to seek a restructuring of bilateral and commercial debt. In early June, it announced that it was restructuring the USD 75 million Eurobond principal payment due on June 13th, having already indicated its desire to restructure its Paris Club debts. The finance ministry reached an agreement on restructuring USD 39.4 million of the bond over a seven-year period, having earlier bought back the remaining 40% at a discount on secondary markets.

3. Structural reform

Improving the business climate and reducing the remainder of government controlled enterprises remains a priority. Corruption and a poor regulatory framework pose significant obstacles to private sector-led growth. In 2002, the government's privatisation plan covered 450 enterprises, of which the 22 amongst the largest are being privatised individually (two electricity grids, Moldtelecom, the tobacco monopoly, eight wineries and a number of industrial plants). Privatisation proceeds have been disappointing and remained below target in 2002. One of the major deals was the June 2002 sale of the Topaz electronic plant to Russia's Salyut for USD 1 million.

Deloitte & Touche, acting as the government's advisor in privatising the electricity grids, recommended putting off privatisation owing to unfavourable market conditions, while tobacco privatisation has been postponed until the industry has been liberalised. The largest privatisation so far was the sale of half the country's electricity distribution network to Union Fenosa of Spain in 1998, backed by the European Bank for Reconstruction and Development (EBRD).

However, following disagreement on electricity tariffs with the government, the Spanish investor has alleged that the government and the business community have tried to impede its activity. Moldova has had little success in attracting foreign investment; its main investors are

the EBRD and the US-supported Western Newly Independent States Enterprise Fund (WNISEF), which often have to cover for departing western private investors.

4. Implementation of exceptional financial assistance

The European Community provided two macro-financial assistance packages worth EUR 45 million and EUR 15 million (Council Decisions EC/94/346 and EC/96/242) to Moldova. In both cases, the Community loans were part of an overall package mobilised by the international community to complement the resources provided by the IFIs. Moldova has so far serviced scrupulously its external financial obligations towards the Community.

In July 2000, the Council approved a new macro-financial assistance loan for Moldova of EUR 15 million (EC/452/2000). By the time the Council Decision was taken, Moldova's arrangement with the IMF under the Extended Fund Facility (EFF), approved in May 1996, expired (in May 2000). It was replaced, in December 2000, by a new three-year arrangement under the Fund's Poverty Reduction and Growth Facility (PRGF). Against this background, it was proposed that the Community macro-financial loan to Moldova be cancelled and replaced by a straight grant of an equivalent amount. Following the consent of the European Parliament, the European Council adopted the Commission Proposal on December 19, 2002 (2002/14307/EC). This new macro-financial assistance will be disbursed in at least two tranches under similar conditions to those foreseen for the disbursement of the loan and will be complementary to financing provided by the IFIs.

VIII. ROMANIA

1. Executive summary

Macroeconomic trends were particularly favourable in 2002 with sustained growth accompanied by sharper disinflation and renewed external retrenchment.

A broadly supportive macroeconomic policy mix underpinned these positive trends but delays in the implementation of structural reforms continued to cast a shadow over medium term prospects.

Despite some progress towards harder budget constraints, excessive wage growth in several public enterprises and persistent arrears to the budget and public utilities were sources of particular concern together with slower-than-planned privatisation and accelerating credit growth.

In January 2002, the EU Council agreed in principle to make available to Romania EUR 100 million, pursuant to Council decision 99/732/EC, in two sub-tranches, subject to the satisfactory implementation of the present SBA and adequate progress in the country's structural adjustment process. Conditions for the disbursement of the first sub-tranche were not yet fulfilled at end-2002.

SUMMARY STATUS OF ECONOMIC REFORM
<p>1. Price liberalisation</p> <p>In 2002, price regulations applied to eighteen goods, ten of which were included in the consumption basket accounting for a share of 20.4%. Regulated prices in the energy sector were adjusted over and above inflation on a regular basis.</p>
<p>2. Trade liberalisation</p> <p>In 2002, Romania's applied MFN tariffs averaged 19.1% on all products as compared to the EC level of 6.3%. As from January 2002, Romania eliminated all remaining customs duties for imports of industrial products originating in the EU and the free trade area for these products was fully accomplished. In 2002, Romania also ratified a free trade agreement (FTA) with Lithuania while formal negotiations to establish FTAs were held with the Republic of Yugoslavia and FYROM and exploratory talks with the Republic of Albania and with Bosnia Herzegovina. Within CEFTA, Romania signed Additional Protocols relating to the liberalization of agricultural and food trade and to the origin of goods.</p>
<p>3. Exchange regime</p> <p>The leu floats within a managed float regime and the exchange rate is used as the main anti-inflationary instrument as long as this does not endanger the external balance. Within this framework, the central bank moved to a policy of less frequent but sizeable interventions allowing for greater exchange rate fluctuations.</p>
<p>4. Foreign direct investment</p> <p>The FDI regime is open and non-discriminatory; profit may be freely repatriated. Since early 1997, foreign investors can own land necessary to carry out their activities. Laws regulating and promoting FDI and portfolio investment have been repeatedly modified, creating legal uncertainty.</p>
<p>5. Monetary policy</p> <p>The National Bank of Romania enjoys a high degree of independence. The Law on the statute of the central bank defines its main objective as ensuring the stability of the national currency in order to contribute to price stability. Although the law still allows for a limited amount of direct financing to the government, this facility was not utilised in 2002.</p>
<p>6. Public finances</p> <p>Basic tax reform has been completed, but major steps to consolidate public finances remain to be implemented, including pension and health reforms. In 2002, however, the enactment of new VAT and profit tax laws, measures to improve the institutional framework for budgetary policy and tax administration, and a reduction in the number of extra-budgetary funds brought about much needed progress towards the elimination of widespread tax exemptions, the improvement of collections, and the development of better budgeting and expenditure control procedures.</p>
<p>7. Privatisation and enterprise restructuring</p> <p>The majority of small and medium-sized companies have been privatised, but many large-scale companies remain public and subject to poor corporate governance and financial discipline. During 2002, privatisation targets agreed in the context of the IMF SBA were repeatedly missed.</p>

8. Financial sector reform

Reform of the banking sector was slow at first, leading to serious difficulties in 1997 and 1999. Subsequently, however, the authorities took major steps to strengthen the regulatory framework while closing or restructuring and privatising the most problematic banks. At end-2002, foreign owned institutions accounted for nearly half of all banking sector net assets. Despite progress, capital markets remained small and underdeveloped.

2. Macroeconomic performance

Following a decade during which soundly based growth has proved elusive, in 2002 Romania's three-year old recovery weathered the economic slow down in the EU as growth remained robust and its composition improved. According to preliminary figures, real GDP expanded by 4.9% in 2002 as household consumption growth cooled off after booming in 2001 and investment spending remained sustained. In a positive reversal of the trends of the past two years, in 2002, stock accumulation did not support growth while net exports did. Despite the slow down in the EU markets that account for some 67% of all Romanian goods sales abroad, exports expanded at an accelerating pace, reaping the cumulative benefits of past private investment in consumer goods industries. Imports, on the other hand, grew at a sustained, but relatively lower, pace thanks to the cooling off of domestic demand and the disappearance of various one-off factors, such as fiscal incentives for capital goods imports, that had boosted their growth in 2001. Methodological changes in the definition of employment and unemployment coverage significantly affected (ILO) labour market data for 2002 making it impossible to compare them to the figures for previous years.

Contrary to the past, positive economic growth was accompanied by greater domestic and external stabilisation. In 2002, disinflation progressed more than expected, with the average rate dropping 12 percentage points to 22.5% and the December-on-December rate falling to 17.8% against an official target of 22%. Disinflation was aided by a favourable evolution of agricultural prices, slower nominal wage growth and a supportive policy mix. The budget deficit target for 2002, in fact, was undershot and the monetary authorities reduced the pace of exchange rate depreciation taking advantage of the positive evolution of the external accounts.

Dispelling the concerns raised by its sharp growth in 2001, the current account deficit dropped more than expected in 2002 when it totalled 3.4% of GDP. After worsening sharply during most of 2001, the external balance began to stabilise thanks to a tightening of the policy stance. Building upon this trend and in spite of the slow down in Romania's main export markets, external developments turned particularly favourable in 2002 thanks to the impressive performance of Romania's sales abroad and increasing private transfers from abroad.

Reflecting this positive macroeconomic performance, external financing conditions have been improving. Better growth, enhanced reform prospects, continued collaboration with the IMF, improved vulnerability indicators and a favourable international market environment allowed Romania to easily meet its external financing needs, *inter alia* by launching its first ten-year euro bond in April 2002. Although on a rising trend, the debt-to-GDP ratio remained fairly low at 34% of GDP at end-2002. Over the year, average debt maturity lengthened, sovereign risk ratings were repeatedly upgraded, spreads on sovereign bonds dropped and external debt service as a ratio of exports of goods and services decreased from 22.4% to 21.6%. Standing at USD 7.3 billion at end-December, official reserves equalled 3.9 months of imports, up from 3.2 months at end-2001.

As in the past, the authorities met the monetary and budgetary targets agreed in the context of the IMF arrangement. In particular, the 2002 general government deficit outcome equalled 2.6% of GDP against a target of 2.9% of GDP as lower-than-projected interest payments and subsidies more than counterbalanced a shortfall in tax revenues. On the monetary front, the central bank proved increasingly successful in achieving its internal and external objectives within the present managed float regime. Despite costly sterilisation operations in the face of strengthening capital inflows, broad money continued to expand rapidly, increasing by nearly 14% on average real terms over 2002. Notwithstanding high, but declining, lending rates, the real stock of credit to the private sector expanded by almost 30%, albeit from a small base. Towards end-year, various measures were taken to slow down this rapid growth, particularly with respect to foreign-currency denominated loans that accounted for more than 60% of all credit to the private sector.

3. Structural reforms

Despite further advances, progress in enterprise reform remained uneven as the authorities struggled to make a clear break with the practises of the past. Although the sale of steel maker SIDEX in 2001 represented an important achievement, in 2002 the privatisation process continued to stagger along despite repeated offers and the approval of a new law aiming at accelerating privatisation. The slow pace of divestitures reflected the poor attractiveness of various enterprises but also persistently non-transparent procedures, political factors and persisting demands for employment and investment commitments by prospective buyers.

Significant but partial advances were achieved in the energy sector where utilities continued to offer quasi-fiscal support to a hard core of loss-making enterprises, thus preventing an effective tightening of their budget constraints. Although politically difficult, the authorities continued to increase energy prices and toughened somewhat their stance towards chronic non-payers. However, further adjustments in (gas) prices and more gains in collection rates are required to improve the financial health of the energy utilities on a sustained basis. While the authorities envisage a wide privatisation of the energy sector as a way to abolish its quasi-fiscal role, implementation of planned intermediate steps has been lengthier than expected.

After many delays, Romania has achieved important progress towards putting the banking system on a sounder basis. In 2002, however, the planned privatisation of BCR run into difficulties. Following the 1999 crisis, several banks were cleaned up and stricter supervisory requirements were introduced and implemented. As a result of these factors, capital adequacy ratios and asset quality improved significantly over the last three years. Yet, various sources of vulnerability remained. With lending to the private sector expanding at a fast pace, the renewed soundness of the banking sector and the enhanced powers of the supervisors are likely to be put to the test. Out of three remaining state-owned banks, the authorities planned to restructure the smallest two and privatise the largest, BCR. However, the two privatisation tenders for the latter launched in the second half of 2002 did not result in any expression of interest deemed legally adequate. A new privatisation schedule involving the early acquisition by the EBRD and the IFC of a blocking minority share was being touted at end-2002.

4. Implementation of macro-financial assistance

Since 1991, the EU has supported Romania's transition process through four macro-financial assistance operations, the latest of which was approved in November 1999 when the EU Council granted Romania a balance-of-payments loan, of up to EUR 200 million, within the framework of a SDR 400 million SBA (Council Decision 99/732/EC). After the release of the first EUR 100 million tranche in June 2000, however, the IMF programme went off track and

eventually expired. No further disbursements of EU macro-financial assistance could therefore take place.

In October 2001, however, the IMF Board approved a new 18-month SBA for SDR 300 million (approximately USD 383 million). In 2002, lengthy negotiations with the World Bank for a second Private Sector Adjustment Loan (PSAL) of USD 300 million were also concluded. Performance under the IMF programme has been mixed and, by end-2002, the completion of the third review had been delayed owing to repeated slippages in wage policy in state-owned enterprises.

Within the context of the current SBA and following a request from the Romanian authorities, the EU Council agreed in principle in January 2002 to make available to Romania EUR 100 million, pursuant to Council decision 99/732/EC, in two sub-tranches, subject to the satisfactory implementation of the SBA and adequate progress in the country's structural adjustment process, notably in the areas of privatisation of the electricity distribution and of the BCR Bank, collection of social contributions and reducing delays in VAT refunds. After lengthy negotiations, a Supplemental Loan Agreement and a Supplemental Memorandum of Understanding (SMOU) were signed in November 2002. Despite significant progress, at end-2002, conditions for the disbursement of the first sub-tranche of EU macro-financial assistance were not yet fulfilled.

IX. SERBIA AND MONTENEGRO

1. Executive summary

Economic policies in Serbia and Montenegro in 2002 continued to be geared towards sustaining macro-economic stability, supporting an ongoing process of dis-inflation and a modest increase in the standard of living. Real output grew by 4%, inflation further declined from 40% to 15%, and the nominal exchange rate has been kept stable while foreign exchange reserves almost doubled to EUR 2.3 billion by end-2002. The fiscal deficit (5% of GDP) was still relatively high and points to the need for further fiscal streamlining.

Structural reforms continued throughout 2002, notably in the banking and enterprise sectors and in the areas of expenditure control and tax policy. Privatisation has gained momentum since early 2002, in particular in Serbia. However, the restructuring of the large enterprise sector and financial sector reform need to be continued vigorously, and further improvements in the overall business climate are essential to support investment and growth.

Out of a first macro-financial package of EUR 345 million adopted in 2001, the second (grant) tranche (EUR 40 million) was disbursed in January 2002 and the third and final (grant) tranche (EUR 45 million) in August 2002 after the authorities had satisfactorily met the economic policy conditions attached to the assistance.

In early November 2002, the Council decided to provide to Serbia and Montenegro further Community macro-financial assistance of up to EUR 130 million, of which EUR 75 million in the form of grants. Following the signature of a Memorandum of Understanding, the grant component of the first tranche of this new package of assistance, EUR 30 million, was released in December 2002, with the loan component, EUR 10 million, released in February 2003. This assistance is being provided in the context of an IMF Extended Arrangement, approved in May 2002.

SUMMARY STATUS OF ECONOMIC REFORM	
1. Price liberalisation	While most price categories are liberalised in Serbia and Montenegro, some exceptions still remain in the area of public services (e.g. transport, utilities). Electricity prices in Serbia are being gradually adjusted towards cost-recovery levels.
2. Trade liberalisation	In Serbia, there remain only moderate restrictions on trade. Most import and export licences and quotas abolished. The average Serbian tariff rate of 9.5% is low, compared to other countries of the Western Balkan region. Montenegro has lower tariffs but a higher degree of non-tariff barriers. Different trade and customs regimes in Serbia and Montenegro, though work on an Action Plan on harmonising tariffs is continuing. Free trade agreements in place with neighbour countries are initialled.
3. Exchange regime	Stable exchange rate in Serbia since early 2001. Convertibility for current and some capital transactions (Art 8 of IMF). Managed float regime under which the exchange rate of the Dinar has been kept stable. Euro serves as an anchor in Serbia and as the sole legal tender in Montenegro.
4. Foreign Direct Investment	The federal Foreign Investment Law adopted in early 2002 improved conditions for foreign investors substantially but heavy procedures for issuing building permits and for enterprise registration still in place. Newly established Foreign Investment Agency to promote FDI.
5. Monetary policy	Strict monetary policy of the National Bank of Serbia (ex-National Bank of Yugoslavia); creation of base money almost exclusively on the basis of foreign exchange increases and limited credits to general government; no sovereign monetary policy in euro-ised Montenegro.
6. Public finance	Tax policy reforms in Serbia continued to encourage investment and employment creation. Tax regime has been made simpler with low rates for corporate (14%) and personal (10%) income tax. Modern (interim) Treasury systems and tax administrations in place in Serbia and Montenegro. VAT in preparation in both republics.
7. Privatisation and enterprise restructuring	In Serbia, privatisation has gained momentum. In 2002, 12 companies were sold through tenders (out of a total of 150 companies to be tendered), and 221 were sold through auctions (out of a total of 3000). 32 large conglomerates are in the process of restructuring. In Montenegro, the large oil company Yugopetrol was sold.
8. Financial sector reform	Enforced banking supervision in place in Serbia. Minimum capital requirement of EUR 10 million. Cleaning-up of domestic banks continued, four large banks in Serbia were closed in early 2002, and a large number of banks are currently being restructured. The legal and regulatory framework for the banking sector in Montenegro has further improved, although financial intermediation is low.

2. Macroeconomic performance

In 2002, growth performance in Serbia and Montenegro was sustained with an increase in real GDP by some 4% in 2002. Real growth was mainly driven by a strong service sector (10-20%), especially transport, and a 1.8% increase in industrial production while agricultural output decreased by 5% compared to 2001. In Montenegro, economic growth (2%) and the increase in industrial output (0.5%) was lower than in Serbia. Official unemployment remained high at 30%, but employment in the informal sector could point to a considerably lower level of real unemployment.

In Serbia, end-of-period retail inflation continued to decline from 40% at end-2001 to a level below 15% in 2002, well below the policy target for 2002 of 20% despite a 50% upward adjustment of electricity prices during the year. In Montenegro, end-of-year inflation declined from some 24% to 10% in 2002, in line with the government's target.

Recent estimates point to a consolidated general government deficit of Serbia and Montenegro (exc. Kosovo) for 2002 in the order of 5.0% of GDP, somewhat lower than the programme target of 5.7%, due to a delay in foreign project financing. The deficit was financed by foreign grants and loans (2.9% of GDP) and receipts from privatisation (about 2.6%).

Revenue performance in Serbia has been mixed. While tax revenues were slightly below planned levels (due to lower than projected inflation), budget revenues from privatisation exceeded their target substantially and amounted to some EUR 400 million in 2002. On the expenditure side some costs were kept below budgeted levels. Montenegro appeared to remain under fiscal pressure. Lower than expected revenues, in particular in the first half of 2002, necessitated some discretionary spending cuts (including capital spending, subsidies and transfers to the pension fund). The consolidated deficit of the republic in 2002 stood at 2.5% of Montenegro's GDP (after 5.3% in 2000 and 8.1% in 2001), however, budget planning for 2003 foresees a substantially higher deficit of 6.1%.

The National Bank of Yugoslavia has continued its stability-oriented monetary policy in Serbia. The money supply (M1) rose further by 80% during 2002, however, this was mainly due to foreign exchange purchases by the NBY against the background of large net inflows of remittances and foreign financing. Gross reserves of the NBY almost doubled during 2002 to reach EUR 2.3 billion at the end of the year, equivalent to around 3.5 months of imports.

Despite a higher than expected trade deficit of some 25% of GDP, the current account deficit before grants could be maintained at 12.8% of GDP in line with the IMF programme. A continuous stronger-than-expected net inflow of remittances from abroad as well as net capital inflows including higher than expected Foreign Direct Investment (estimated at EUR 570 million) and loans from official creditors have more than offset the current account deficit leading to the above-mentioned substantial increase in foreign exchange reserves. The exchange rate of the Dinar has remained broadly stable at the level of JUD 59 to 1 EUR since the end of 2000, reflecting both increased confidence in the domestic currency and favourable developments in the foreign exchange market.

The external debt stood at USD 11.5 billion or 74% of GDP. The external sustainability of the economy of Serbia and Montenegro will remain a challenge even after the Paris Club agreement of November 2001 that reduces the NPV of the debt by 66% in a phased manner. The authorities have not yet reached a debt restructuring agreement with the London Club of creditors, which has so far been reluctant to grant the country similar generous terms.

Important financing requirements, mainly resulting from the current account deficit, debt service and the need to further increase foreign exchange reserves, will continue to put a heavy strain on the balance of payments. According to an IMF study scenario, debt servicing will rise in the period 2002-2009, from 1.3 to 6 % of GDP or from 3 to 15% of government revenues.

3. Structural reforms

In Serbia, public finance reforms continued with the adoption in February 2002 of a new budget law. Expenditure control has been improved considerably through steps to set up a Treasury system, that is expected to become fully operational in Spring 2003. Also, tax reforms continued with a view to reduce taxes, improve tax collection and combat corruption and grey market activities. In late September 2002, the Serbian government approved a set of new tax policy measures aimed at stimulating investment and employment creation. Measures include a reduction of corporate taxation from 20% to 14%, tax holidays for new investments and employment above certain thresholds, exemptions from the sales tax for a number of goods, as well as the abolition of the capital gains tax. Most of the new tax laws were endorsed by the Serbian Parliament in November 2002.

In Montenegro, an interim Treasury became fully operational at the beginning of 2002. A new procurement law was enacted in mid-2002. Montenegro has continued tax reforms with support from foreign advisors. At the end of 2001, the Montenegrin Parliament approved a package of six tax laws. Four of these laws, namely the laws on income and profit taxation, on excises and on tax administration have already been implemented in the course of 2002. The authorities were expecting positive effects of these new laws on revenue collection in the second half of 2002 and in 2003 after revenue performance had been below target in the first half of 2002. The two remaining laws of the 2001 package, the tax on real estate and the VAT law were planned to come into force in early and mid-2003, respectively. A Large Taxpayer Office was established in Podgorica in mid-2002.

In Serbia, the process of privatisation through tenders and auctions has gained some momentum in 2002. First rounds of auctions were held at the Belgrade Stock Exchange in Spring and Summer 2002 with limited success. In August 2002, the authorities decided to streamline auction procedures, which led to a substantial acceleration of privatisation. Progress in the area of enterprise restructuring has continued to be limited. In Montenegro, the main success was the sale of Yugopetrol to a Greek company in October for some EUR 65 million cash and some EUR 35 million investment commitments.

The Federal authorities made further progress in strengthening banking supervision by the central bank. A revision of the law on banks came into force in April 2002; it obliges banks to comply with stricter prudential regulations, to harmonise minimum ratios in line with Basle and EU standards, to define credit policies and to organise internal audits. A bank bankruptcy law was already enacted in October 2001.

Further progress in restructuring and cleaning up the banking sector in *Serbia* has been achieved. At end-2002, eight banks were under liquidation procedures of the Bank Rehabilitation Agency (BRA), including four large insolvent state-owned banks that were closed in January 2002. Some 15 banks, in which the state had obtained shares through debt-equity-swaps, were in the process of rehabilitation under the BRA. Following the adoption of new banking legislation in *Montenegro* at end-2000, all banks were subjected to on-site assessments and applied for new licences. Seven banks were re-licensed, and two new licenses were issued, one of which for a bank with private ownership. The government's decision to rehabilitate the largest bank, Montenegro Banka, was taken in late December 2001

and in early 2002 the government assumed EUR 11.5 million guaranteed liabilities in exchange for non-performing assets of EUR 24 million. The authorities intend to privatise the bank in early 2003.

4. Implementation of macrofinancial assistance

Out of the first macro-financial package of EUR 345 million assistance in favour of the country decided in 2001, the second (grant) tranche of EUR 40 million was disbursed in January 2002, followed in August by the release of the third and final tranche of EUR 45 million after the authorities had satisfactorily met the structural adjustment conditions attached to the release of the respective tranches. These conditions specified policy measures in line with the authorities' objectives and the IMF programme, mainly in the areas of public finance, private sector development and banking sector reform.

In early November 2002, the Council decided to provide to the country further Community macro-financial assistance of up to EUR 130 million, of which EUR 75 million in the form of grants. The objective of this assistance is to underpin economic policies in the context of the three-year IMF Extended Arrangement (2002-2005) approved in May, and in particular to support the balance of payment and strengthen the foreign exchange position of the country. A Memorandum of Understanding (MoU) was negotiated and agreed between the Commission Services and the authorities in December 2002. This MoU specifies the economic policy conditions and structural measures for the release of the second and the third tranche of this assistance. In particular it defines measures in the areas of public finance reform and administration, banking sector reform and private sector development and contains also measures that support the harmonisation of economic systems within Serbia and Montenegro, especially with respect to the introduction of common tariffs, VAT and company registries.

The grant component of the first tranche of this new package of assistance, EUR 30 million, was released in end-December 2002, following the signature of the MoU. The authorities have allocated 10% of the proceeds to Montenegro and 90% to Serbia. The loan part of the first tranche of EUR 10 million followed in February 2003; the delay was due to the pending completion of the ratification procedures in the federal Parliament of the Loan Agreement between the EC and the country.

X. SERBIA AND MONTENEGRO / KOSOVO²

1. Executive summary

GDP growth slowed to some 7% in 2002 (compared to 11% the year before) partly reflecting the reduction of international presence and donor assistance. Inflation is estimated to have declined from 11 percent in 2001 to the order of 4% in 2002. The gradual reduction of aid flows and the international presence will smoothen inflation pressures further. Manufacturing and export activities remain subdued and unemployment is high.

UNMIK, and particularly its EU-led Pillar IV responsible for economic reconstruction and development, has further progressed in important economic areas. It has enhanced revenue collection and tax compliance. The financial sector has developed favourably in terms of growth and product range. In mid-2002, the Kosovo Trust Agency (KTA) was formally established and is responsible for privatisation of socially-owned enterprises and the control of public enterprises. So far, no enterprise has been privatised.

In continuation of its support, the Council decided in June 2001, following a Commission proposal, to provide further exceptional Community financial assistance to Kosovo of up to EUR 30 million in the form of a grant (2001/511/EC). The disbursement of the second and final EUR 15 million tranche took place in December 2002 upon a satisfactory implementation of economic policy measures agreed for this assistance.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Prices are liberalised with the exception of a few public services.

2. Trade liberalisation

UNMIK applies an amended FRY customs code, charging a 10% customs rate, varying excise duties, and sales tax (15%), replaced by the VAT in July 2001, on imported goods. It does not charge customs on goods originating in the rest of FRY. UNMIK has maintained the preferential trading arrangements of FRY with the former Yugoslav Republic of Macedonia.

3. Exchange regime

The use of the euro/D-Mark (and other currencies) has been legalised, albeit the Yugoslav Dinar remains the legal tender. Kosovo followed the schedule of the EU to convert the cash circulation to euro in the beginning of 2002.

4. Foreign direct investment

The establishment of the commercial law framework has advanced. However, the business environment remains unfavourable resulting from the unsettled political situation and legal uncertainties.

5. Monetary policy

Given its status, Kosovo does not have a Central Bank nor a monetary policy. The Banking and Payments Authority of Kosovo (BPK) exercises a number of functions usually attributed to a central bank including the preparation of the changeover to the euro from January 2002 onwards.

6. Public finances

The domestic revenue base has been developed over time including the introduction of new taxes and measures to enhance revenue collection. The split in responsibility between reserved and transferred power impeded the development towards a comprehensive budget.

7. Privatisation and enterprise restructuring

Privatisation of public enterprises is hampered by legal uncertainties. Prior to this, a number of public undertakings still need to be incorporated. The KTA is expected to play a key role in enterprise reform and privatisation.

8. Financial sector reform

Within the regulatory and supervisory framework of BPK, the seven licensed banks established a province-wide branch network and provide basic banking products. The payments system increased the number of non-cash transactions. A regulatory and supervisory framework for the insurance sector is in place.

²

Under international administration in line with UNSCR 1244 of 10 June 1999.

2. Macroeconomic performance

According to the still weak database, the real growth rate slowed to some 7% in 2002 (compared to 11% the year before) partly reflecting the reduction of international presence and donor assistance. Growth is expected to decline further to be in the order of 5% in 2003. Reconstruction is still going on, agriculture is recovering and there is a vibrant private service sector. The high unemployment (according to the authorities in the order of 50%) and the weakness of the social security system remain challenging issues. Inflation is estimated to have declined from 11 percent in 2001 to the order of 4% in 2002. The gradual reduction of aid flows and the international presence will also place downward pressure on inflation.

The provision of public services has improved but public utilities, notably the energy utility, continue to suffer from unreliable supply and still very low cost recovery. The situation in the energy sector has been aggravated again by a lightning strike in July 2002, which seriously damaged one power plant. As regards infrastructure, the improvement of road quality is visible but the main arteries suffer from degradation due to the permanent use of heavy traffic including military. Nearly 100% of the rail track is considered operational, which is reflected in increasing passenger and freight flows. Telecommunication largely relies on the mobile network but the PTK (Post and Telecommunication company of Kosovo) is preparing investment programmes to upgrade the fixed line network.

As regards the budget 2002, economic growth, the introduction of modern taxes (like income and profit tax) and the broadening of the tax base contributed to a further increase in expected domestic revenues: preliminary data suggest that revenues totalled some EUR 476 million, 15% above the estimate of the mid-year review. This positive development allowed for an increase in budget expenditure devoted to a large extent to the establishment of a government structure. Total consolidated government expenditures are estimated at EUR 552 million for 2002, essentially in line with the mid-year review. As a consequence of the better revenue performance, the overall deficit before grants, including the one-off capital expenditure related to the use of the accumulated cash balance, is estimated at EUR 75 million compared to EUR 134 million in the mid-year review.

Adding the outlays for the Public Investment Programme (PIP) of an estimated EUR 378 million (compared to originally estimated EUR 411 million) results in the Kosovo Integrated Budget (KIB). The financing gap of the KIB remains unaffected since PIP expenditures are entirely funded by donor grants.

Kosovo does not carry out a monetary or exchange rate policy since its de-facto currency has been the DM, followed by the euro since the successful conversion in the beginning of 2002. Even though the forces of past growth weaken, economic activity is still driven by donor funded reconstruction resulting in considerable official transfers and a huge trade deficit. Despite first signs of a shift from retail trade to other economic activities including manufacturing, the economic recovery is still too weak to have a sizeable impact on exports. Owing to the official transfers, remittances and factor income from donor-related employment, the current account showed a surplus in the past years.

3. Structural reforms

In 2002, UNMIK introduced a three-pillar pension system. The first pillar comprises a pay-as-you-go-system financed from contributions (including a universal benefit scheme for those who did not contribute to the past pension system). As second pillar, a "Individual Savings

Pensions” has been introduced, which is based on compulsory contributions by employers and employees (currently 5% of salary by each party). The contributions are collected via the Tax Administration and paid to the Kosovo Pensions Savings Trust (KPST). The third pillar comprises the “Supplementary Employer Pension Funds”/“Supplementary Individual Pension Funds” provided by licensed pension providers.

Today, the 7 commercial banks licensed by the Banking and Payments Authority of Kosovo (BPK) have a total of 122 banking offices (branches, sub-branches and offices) located throughout Kosovo, including minority areas. In addition, 17 Micro-Finance Institutions (MFI) and 4 exchange offices have been licensed by the BPK. Total deposits in the banking system are EUR 434 million and outstanding loans total EUR 90 million from banks and EUR 34 million from MFIs, which represents an increase of 164% in outstanding loans to the economy from a year ago. For the insurance sector, there are 8 insurance companies licensed by the BPK and one receiving a preliminary license. In addition to Third-Party-Liabilities insurance, other types of insurance are now available. Six additional classes of business have been approved for three companies: Fire, Personal Accident (PA), Construction all Risk (CAR), Physical Damage to vehicles (CASCO), Directors and Officers Liability (D&O) and Professional Liability. Two Insurance Rules provide for a comprehensive investment policy for insurance companies.

As of 1 July 2002, the Kosovo Trust Agency (KTA), formally established in mid-June 2002, had taken over the control over all public enterprises previously shared among Pillars. The KTA was granted wide responsibilities: authority and rights of a trustee, the administration of all public enterprises (55) and "socially owned enterprises" (SOEs, up to 550). The KTA has the authority to transfer of assets to new companies (“spin-off approach”) and to liquidate enterprises and to initiate bankruptcy proceedings. Only SOEs will be privatised. The KTA is expected to play a key role in enterprise reform and privatisation. After a year of preparation, the KTA privatisation team has identified candidate enterprises for special spin-off (12), regular spin-off (app. 45) and liquidation. The outstanding issue of the use of land seems to be close to being adopted. It is estimated that only 20% of the SOEs can be privatised as going concerns. The receipts of privatisation shall be kept on trust accounts until any possible claims have been settled. Audits of public enterprises could not be undertaken before the transfer of the enterprises to the KTA. Audits on KEK (the Kosovar Electricity company), PTK (Post and Telecommunication Kosovo) and Pristina airport are currently being carried out; within the next 4-6 months other major enterprises are due to be audited, too. The KTA is preparing plans for a restructuring of public enterprises, including their incorporation. A regulation establishing a legal framework in the energy sector is being implemented. Progress in the commercial law framework has been slow in the last 18 months.

Even though a number of draft regulations had been completed and transmitted for legal clearance, the legislative progress was seriously hampered by the preparation of the elections in November 2001 and subsequent delays in establishing the Provisional Institutions of Self-Government (PISG). According to the Constitutional Framework, economic legislation is part of the powers transferred to the PISG and thus the Kosovo Assembly is assigned with its adoption.

4. Implementation of exceptional financial assistance

Following the provision of a first exceptional financial assistance grant of EUR 35 million in 2000 as part of a broader Community assistance package of EUR 360 million, another grant of up to EUR 30 million has been approved in June 2001 (2001/511/EC). Its purpose was to alleviate the financial situation in Kosovo, to facilitate the establishment and continuation of

essential administrative functions and to support the development of a sound economic framework. These funds were provided in close contacts with the International Financial Institutions, notably the IMF and the World Bank, both at working level as well as via the regular meetings of the Working Level Steering Group monitoring the economic and financial developments in Kosovo (under its current status, Kosovo does not benefit from the IMF or World Bank under conventional programmes).

A first tranche of EUR 15 million was disbursed in mid-September 2001 following the signature of a Memorandum of Understanding (MoU) between UNMIK and the Community. The release of the second tranche is subject to satisfactory compliance with economic policy conditions as laid down in the MoU. These include measures to promote the financial and private sector development, to produce macro-economic data, and, most importantly, to develop the revenue base further so as to pursue prudent budgetary policies.

Following a first mission in November 2001, another Commission staff mission was carried out in June 2002, to review the progress with respect to meeting the conditions attached to the release of the second tranche of this assistance. Based on broadly satisfactory implementation of conditionality and further identification of needs in the context of the donor co-ordination meeting on 5 November 2002, the second tranche of EUR 15 million was disbursed in December 2002.

XI. TAJIKISTAN

1. Executive summary

Tajikistan's macroeconomic performance remained relatively strong in 2002 with an estimated real GDP growth rate of 9.1% (10.2% in 2001). Aluminium production continued on its increasing trend and also the cotton harvest was good. At end-2002 the consumer price inflation was 14.5% (12.5% at end-2001). The current account position improved significantly in 2002. The deficit narrowed to about 4.2% of GDP (7.2% in 2001).

After a slowdown in 2001 privatisation gained some more speed in 2002 in the construction, transportation, trade and light manufacturing. A new two-year privatisation strategy was approved in July 2002 with a renewed focus on large enterprises. In the banking sector, several banks have difficulties in fulfilling the new prudential requirements.

The IMF Board approved in December 2002 a three-year arrangement under the PRGF with a total available amount of SDR 65 million (about USD 87 million) to support the government's economic programme.

A Commission staff mission to Dushanbe concluded positively a review on the Community exceptional financial assistance in June 2002. The disbursement of the 2002 grant tranche of EUR 7 million took place in early 2003 following the IMF approval of the new PRGF arrangement for Tajikistan and an early debt repayment of EUR 8 million by Tajik authorities to the Community.

2. Macroeconomic performance

Tajikistan's real GDP growth in 2002 is estimated at 9.1% (10.2% in 2001). Output in agriculture picked up 15% and industrial production increased by 8.2% driven by the aluminium sector. After a declining trend in monthly inflation rates in the first half of the year, rapid growth in reserve money contributed to a spike in inflation in the third quarter as the National Bank of Tajikistan issued directed credits to the cotton sector countervailing its previous policy announcements. The year therefore ended with consumer price inflation at about 14.5% (12.5% at end-2001), with highest increases seen in food prices. The National Bank of Tajikistan maintains a managed floating exchange rate regime allowing the somoni to depreciate in nominal and real terms. In 2002 the somoni depreciated some 15% against the USD, for the most part after the lapse in monetary policy in the third quarter.

SUMMARY STATUS OF ECONOMIC REFORM	
1. Price liberalisation	Most prices liberalised (with the exception of public utilities).
2. Trade liberalisation	Relatively liberal trade system with persistent non-tariff barriers, however. Import tariffs were unified at 5 percent in May 2002. Tajikistan has applied for membership in the WTO (observer status since 2001). The Eurasian Economic Community (including Russia, Belarus, Kazakhstan, Kyrgyz Republic and Tajikistan) aims at promoting regional economic co-operation.
3. Foreign exchange regime	Relatively liberal exchange regime. Official exchange rate unified with curb market rate in July 2000 when an interbank foreign exchange market began operating. The new currency, somoni, introduced in October 2000. Managed floating of the somoni.
4. Foreign direct investment	Modest foreign direct investment due to high perceived country risk, despite a relatively liberal legal regime. No legal obstacles to foreign direct investment or to foreign ownership of shares, no restrictions on the repatriation of profit and capital. FDI inflows 0.9% of GDP in 2001.
5. Monetary policy	Independence of the National Bank of Tajikistan is reasonably assured under the Law, but in practise the National Bank has been under pressure to provide directed credits.
6. Public finances	Total revenues (incl. grants) about 16% of GDP in 2002, tax revenues about 15% of GDP; current expenditure about 14.5% of GDP. Public Investment Projects amount to about 2.8% of GDP.
7. Privatisation and enterprise restructuring	The privatisation of small enterprises is largely completed. Some 40% of medium and large enterprises privatised. Land reform has slowed down since 2000 because of interference from local governments. About half of arable land is in private hands through long-term leases.
8. Financial sector reform	Recently, significant progress in improving banking regulation and supervision. Restructuring agreements between the NBT and the four main banks. Lending to insiders and non-collection of loans remain widespread. Confidence in the system is still low and ability to mobilise savings remains limited (bank deposits about four percent of GDP).

The fiscal stance deteriorated slightly in 2002 with a deficit of 1% of GDP (0.1% in 2001) owing to expenditure increased in public salaries and reductions in cotton sales tax rates and income tax rates which are part of a larger tax reform agreed with the IMF. In 2002 the public investment programme (PIP) financed by concessional foreign lending was not yet included in the general government balances. Including the PIP explicitly in the fiscal balances brings the general government deficit to about 3% of GDP.

Owing to a good cotton harvest together with an increase in aluminium production, exports increased by 13% while imports were up by only 4.4%, which brought the trade balance into a surplus in 2002. Aluminium accounted for nearly 55% of total exports. The current account deficit is estimated to have been reduced to about 4.2% of GDP in 2002 (7.2% in 2001). Excluding transfers, the current account deficit is estimated at about 12% of GDP (15.3% in 2001).

In December 2002, Tajikistan reached an agreement with Russia on restructuring the outstanding debt, involving also a partial write-down. The agreement contributed to the reduction in Tajikistan's external debt from USD 1.02 billion (98% of GDP) at the end of 2001 to USD 985 million (88% of GDP) at the end of last year. Debt service was a high burden on the country in 2002 corresponding to over 40% of fiscal revenues. The National Bank's gross international reserves increases during 2002 and corresponded to 2.3 months of imports at the end of the year (1.9 months at end-2001).

During the first half of 2002, Tajikistan implemented an IMF Staff Monitored Programme aimed at reinforcing the commitment to economic reform. In 2002 the Tajik Government adopted the Poverty Reduction Strategy Paper (PRSP). The IMF Board approved in December 2002 a new arrangement for the Republic of Tajikistan under the Poverty Reduction and Growth Facility to support the government's economic programme through September 2005. Tajikistan was able to draw SDR 8 million (about USD 11 million) under the arrangement by end-2002.

3. Structural reforms

Owing to the civil war which followed the independence of Tajikistan, the structural reform did not begin in earnest until after 1997.

Although private ownership of land is banned in the constitution, the restructuring of state and collective farms and the issuance of land use rights has brought positive results with yields reaching 2-3 times the yields on public farms. Raw cotton yields have particularly picked up in 2000-2002. In 2002 the government reduced land registration costs and agricultural taxes in three pilot districts with a view to encourage the reform process. It is estimated that about half of total arable land is currently in private hands. The authorities intend to privatise the remaining state-owned farms (about 220) by 2005.

Privatisation of medium and large enterprises has progressed albeit slowly, by end-2002, about 40 % had been sold to the private sector. The Government adopted a new privatisation strategy in July 2002 for the coming years. In light manufacturing there are signs of productivity gains from privatisation while industrial production as a whole is still dominated by the state-owned TADAZ aluminium smelter. In June 2002 the Government and the World Bank signed a plan on bringing private management to the TADAZ.

The EBRD has estimated on the basis of business surveys that the average "bribe tax" is at about 2.6% of firms' annual total sales. According to the same survey, the share of firms which pay bribes frequently is 35.1%.

Quasi-fiscal deficits of the energy sector are estimated at 5-6 % and remain to be addressed by the Government. Tajikistan is the most intensive energy user in the CIS, partly owing to its aluminium production. The authorities have begun to take measures in the gas sector to prevent further accumulation of arrears.

The Parliament adopted a new telecommunications law in April 2002 establishing a regulatory agency in the sector, and a tariff reform was launched.

The consolidation of the banking sector through mergers, and possibly also through closing of some banks, is pending. Prudential regulations have been tightened but the adherence to the minimum capital requirement of USD 1.5 million for existing banks is not yet sanctioned by the National Bank of Tajikistan. In mid-2002, 9 out of the 14 banks did not meet the minimum requirement. The restructuring plans for the two largest banks (Agroinvestbank and the state-owned Amonatbank) were finalised in 2002 and a separation of non-bank functions from the retail banking proper is being planned.

Tajikistan has finalised the Poverty Reduction Strategy Paper (PRSP) which was endorsed by the IDA and the IMF in December 2002. The PRSP provides a multi-sector approach to poverty reduction but given that three quarters of the population live in rural areas the agricultural sector policies will play a central role. In the allocation of scarce budgetary resources, the priority will be given to increasing social expenditures.

4. Implementation of macro-financial assistance

Tajikistan has benefited from an assistance package which consists of a loan of EUR 60 million (disbursed in March 2001) and a total grant amount of up to EUR 35 million to be disbursed in successive annual tranches over the period extending to 2004. A Commission staff mission assessed in June 2002 the progress made in fulfilling the conditionality for the third grant tranche.

Given that Tajikistan made satisfactory progress in structural reforms (notably with the improvement of the taxation system, with the privatisation process, and with measures related to restructuring of the banking sector), a disbursement of the maximum annual amount of EUR 7 million was proposed. The disbursement was however conditional on the agreement between Tajikistan and the IMF on a new arrangement under the PRGF. Following the approval of the new arrangement by the IMF Board in December 2002, the grant tranche was disbursed in early 2003 after Tajikistan had first reduced its net debtor position towards the Community by EUR 8 million as agreed. Therefore, Tajikistan's outstanding debt to the Community was reduced from EUR 52 million at the end of 2002 to EUR 44 million in January 2003. The Commission services also reached an agreement with the Tajik authorities on the structural conditionality for the 2003 grant tranche (up to a maximum of EUR 7 million). The specific conditions were identified in the same areas as the year before (such as tax revenue collection, energy sector reform and financial sector reform) and they are consistent with policies pursued by the authorities in the context of the Poverty Reduction Strategy Paper.

XII. UKRAINE

1. Executive summary

Ukraine continued to show a broadly satisfactory macroeconomic performance in 2002. GDP growth decelerated from the exceptionally high rate of 9.1 percent recorded in 2001 but remained significant at 4.1%. Inflation continued to surprise on the downside, with consumer prices actually falling by 0.6 percent. Despite the slowdown in economic growth, the fiscal position was kept under control, although this partly reflected the accumulation of additional arrears on VAT refunds.

Ukraine's external financial position has also strengthened considerably. The current account remained in surplus in 2002. Following a sharp depreciation between July 1999 and January 2000, the hryvnia has been relatively stable in nominal terms and official foreign exchange reserves have shown an upward trend since the spring of 2000. Moreover, in early December 2002, Ukraine regained *access to the international capital markets* with the issuance of a USD 399 million sovereign eurobond. FDI inflows, however, remain low.

The implementation of *structural reforms* lost considerable momentum in 2002, partly reflecting a unstable political environment. While some positive steps were taken in the financial sector and trade areas, progress with large-scale privatisation and energy sector reform continued to be disappointing.

The IMF's extended arrangement (EFF) expired in September 2002 and negotiations on a programme that could be supported by a precautionary stand-by arrangement (SBA) have not made sufficient progress. In July 2002, the Council adopted a Decision granting a new macro-financial assistance to Ukraine in the amount of up to EUR 110 million and cancelling the undisbursed part of the 1998 loan facility. The discussions on the conditionality of the new facility, however, have been delayed due to the interruption of the EFF and delays in the negotiations on a successor IMF arrangement.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices have been liberalised. Communal services tariffs (such as gas, electricity, heating, and rents) are subject to administrative control and tend to be below full-cost recovery levels.

2. Trade liberalisation

Import regime free of quantitative restrictions, with a few exceptions for health and safety reasons. Trade-weighted average import tariff was 7% at end-2002. A uniform 2% import surcharge was imposed in July 1999 for six months. A few export restrictions (such as export duties on sunflower seeds, animal skins and scrap metal) remain. PCA with EU entered into force on 1 March 1998.

3. Foreign exchange regime

Full current account convertibility (Article VIII status at the IMF) since September 1996. Certain foreign exchange restrictions on current transactions were reintroduced between September 1998 and August 1999 to defend the currency.

4. Foreign direct investment

Tax relief granted to some investments constituting at least 20% of an enterprise's capital and to investments in the automobile industry above USD 100 million. FDI inflows have remained very low on a per capita basis (they reached only USD 748 million, or USD 15.3 per capita, in 2001).

5. Monetary policy

It mostly relies on indirect monetary instruments. Central bank credit to commercial banks allocated mostly through the Lombard facility, credit auctions and repos.

6. Public finances

Consolidated government expenditure reduced from about 70% of GDP in 1992 to about 37% of GDP in 2001. Public employment cut by 1 million (to 4.7 million) between 1994 and 1998. Consolidated government deficit reduced from 5.2% of GDP in 1997 to 1.5% of GDP in 2001. Social security contributions, the VAT and the profit tax are the main sources of revenue, accounting together for about 70% of consolidated government tax revenues.

7. Privatisation and enterprise restructuring

Small-scale privatisation virtually completed. Over 9 500 enterprises privatised through a mass (voucher) privatisation scheme launched in early 1995. Privatisation programme is now focusing on the large enterprises, including those in the energy and telecommunications sectors. Limited involvement of foreign or strategic investors. According to the government, private sector accounted for about 60% of industrial output in 1998.

8. Financial sector reform

Significant efforts made since 1997 to strengthen banking supervision and regulation, including the adoption of laws on the central bank and on banking activities in 1999-2000, the introduction of the International Accounting Standards, and the establishment of a new reporting system for banks. Most banks are privately owned. The banking system, however, remains weak, with some of the largest banks in poor condition. Banking licence of one such bank was withdrawn in 2001. Capital markets remain underdeveloped.

2. Macroeconomic Performance

Ukraine has continued to show a broadly satisfactory macroeconomic performance. The economy has continued to expand at a relatively high rate, although the rate decelerated from 9.1% in 2001 to 4.1% in 2002. Annual *inflation*, which had already declined from 25 percent in 2000 to 6.1 percent in 2001, became negative in 2002, with the consumer price index falling by 0.6 percent. This impressive inflation performance partly reflects prudent monetary and fiscal policies and the relative strength of the exchange rate. It also reflects however the postponement of energy price adjustments, which are still controlled by the government. The need to adjust administered prices and recent large wage increases in both the private and the public sectors raise some doubts about the sustainability of these favourable inflation trends.

Despite the slowdown in economic growth, the *consolidated government* managed to close 2002 with a small surplus. This reflected the implementation of expenditure cuts but also the accumulation of additional arrears on VAT refunds. The budget for 2003 foresees a consolidated deficit at about 1 percent of GDP, implying a significant fiscal expansion. The authorities intend to pass through parliament in 2003 a new Tax Code that would cut rates in a number of taxes, reduce exemptions and rationalise the tax system.

The balance of payments has improved considerably in recent years. The *current account* has been in surplus since 1999. The surplus is estimated to have been in the order of 3½ percent of GDP in 2002, supported by strong receipts from current transfers and services. The *debt reschedulings* agreed with private bondholders in April 2000 and by the Paris Club in July 2001 have significantly eased Ukraine's debt service obligations and *official international reserves* have continued to rise, reaching about USD 4.4 billion, or 2½ months of imports, at end-2002. Moreover, in early December 2002, Ukraine regained *access to the international capital markets* (which it lost in the wake of the Russian crisis of 1998) with the issuance of a USD 399 million sovereign eurobond maturing in 2007. The government plans to issue more eurobonds in 2003. FDI inflows, however, remain disappointingly low. Ukraine's *external debt stock* stood at the equivalent of about 25 percent of GDP at end-2002.

Ukraine has had a floating *exchange rate regime* since January 2000. The hryvnya has been remarkably stable in nominal terms since the sharp depreciation it experienced in 1999. Given the inflation differential that Ukraine exhibited vis-à-vis its main trading partners until last year, this has led to a significant appreciation of hryvnya in real terms. The exchange rate is nonetheless believed to remain at a relatively competitive level.

3. Structural Reforms

Progress with *structural reforms* lost considerable momentum in 2002, partly reflecting a confrontational political environment and the stalemate surrounding the parliamentary elections of March and the government reshuffle of November. This section reviews developments in the reform areas emphasised by the conditionality of the EU's macro-financial assistance.

Progress on the *privatisation* front was again disappointing in 2002, partly due to the freezing of the privatisation of the regional electricity distribution companies and new delays in the privatisation of Ukrtelecom, the state-owned telecommunications monopoly. At only about 600 million hryvnias, privatisation revenues were much lower than the amount that had been foreseen in the 2002 budget (5,83 billion hryvnias). The budget for 2003 assumes a significant increase in privatisation revenues (to 2.15 billion hryvnias) but this target looks difficult to attain in view of the limited receipts obtained in the first two months of the year (120 million hryvnias) and the uncertainties over the privatisation of some key companies.

In the area of *financial sector reform*, the authorities have continued to take steps to strengthen banking supervision, with technical assistance from foreign donors. Also, a central regulator for non-financial institutions was established in late 2002. Significant weaknesses remain, however, in some of the largest banks, in particular in the state-owned Savings Bank and in UkrExport-Import Bank. In the context of the PAL operation with the World Bank (see below), the authorities signed a Memorandum of Understanding for the restructuring of the Savings Bank in July 2002 but its implementation has fallen behind schedule. Also of concern is the adoption by the National Bank of Ukraine in the summer of 2002 of a scheme to provide loans to the commercial banks at its short-term refinancing rate for the funding of medium-term lending to certain sectors or enterprises.³

In the *energy area*, the improvement in cash collection rates that had been observed in the electricity and gas sectors in 2001 continued in 2002. On the other hand, there was no further progress with the privatisation of the regional electricity distribution companies, with the authorities insisting on the need to restructure their debts before selling additional companies. No progress was made either with the reform and privatisation of the gas sector, which continues to be characterised by a high degree of state ownership and concentration and a lack of transparency. In the nuclear area, the authorities asked in November 2001 for a renegotiation of certain aspects of the Euratom and EBRD loan contracts for the K2R4 project, which has resulted in an additional postponement of the final approval of this project.

In the area of *trade liberalisation*, Ukraine made substantial progress in the WTO accession negotiations, with a number of key protocols having been signed. Ukraine also took steps to bring its regulations on intellectual property in line with WTO requirements and improving their degree of enforcement. The new Customs Code adopted in July 2002 is also compatible with WTO rules, and technical standards are being harmonised with those of the EU. On the negative side, Ukraine introduced an tax on exports of scrap metal in December 2002 and continues to impose taxes on exports of sunflower seeds and animal skins.

4. Implementation of EU Macro-Financial Assistance

In October 1998, the Council granted to Ukraine a third *macro-financial assistance* of up to EUR 150 million.⁴ The first tranche (EUR 58 million) was disbursed in July 1999. Discussions on the conditions for the release of the second tranche, however, were interrupted due to problems with the IMF's EFF. A Council Decision approving this new assistance (and cancelling the undisbursed part of the 1998 loan facility) was adopted on 12 July 2002. This new assistance amounts to EUR 110 million (including the EUR 92 million that remained

³ This scheme, which has been criticised by the IMF, involves an implicit subsidisation of the banks and, indirectly, the beneficiary enterprises.

⁴ The first and second MFA operations, in the amount of EUR 85 million and EUR 200 million, respectively, were approved by the Council in December 1994 and October 1995.

from the 1998 operation) and has a longer maturity than the 1998 operation (15 years instead of 10) and a longer grace period (10 years instead of 7). The discussions on the conditionality of this new facility, however, have been delayed due to the interruption of the EFF and delays in the discussions over a successor IMF arrangement.

In September 1998, *the IMF* approved an EFF for Ukraine in the amount of USD 2.2 billion, later augmented to USD 2.6 billion. The EFF ran off-track several times since its inception. Disagreements over fiscal policies and slow progress with structural reforms put the programme off-track in January 2002. The EFF expired in September 2002 but the authorities have expressed their desire to replace it with a precautionary SBA. In February 2003, an IMF mission held discussions with the authorities in Kiev on the main elements of a programme that could be supported by such an arrangement. While agreement was reached on certain issues, including a broad framework for monetary and fiscal policies and measures to strengthen the banking system, a number of unresolved issues remain. These include, in particular, the clearance of arrears on VAT tax refunds, the sharp increase in public sector wages planned for the period 2003-04 and the lack of transparency in the accounts of the national gas company.

World Bank lending has focused on public sector reform, the agriculture and energy sectors, privatisation and financial sector reform. In this last area, three adjustment operations (the EDAL I and II and the FSAL) have been approved since 1996, for a total of USD 910 million. In September 2001, the World Bank approved a Programmatic Adjustment Loan (PAL) of USD 250 million, which was fully disbursed in two tranches in September and December of that same year. This operation, which covers several areas of reform, emphasises financial discipline, the regulatory framework, ownership, fiscal accountability and social sustainability. A second PAL operation of the same amount and similar characteristics is under preparation.

ANNEX

Annex 1A - COMMUNITY MACRO-FINANCIAL AND EXCEPTIONAL FINANCIAL ASSISTANCE TO THIRD COUNTRIES BY DATES OF COUNCIL DECISIONS

Status of effective disbursements as of end-December 2002 (in millions of euro)

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals</u>	
Hungary I (Structural adjustment loan)	22.02.90	90/83/EC	870	Apr. 1990 Feb. 1991	350 260	610	260 (Suspended)
Czech and Slovak Federal Republic (BOP loan)	25.02.91	91/106/EC	375	Mar. 1991 Mar. 1992	185 190	375	
Hungary II (BOP loan)	24.06.91	91/310/EC	180	Aug. 1991 Jan. 1993	100 80	180	
Bulgaria I (BOP loan)	24.06.91	91/311/EC	290	Aug. 1991 Mar. 1992	150 140	290	
Romania I (BOP loan)	22.07.91	91/384/EC	375	Jan. 1992 Apr. 1992	190 185	375	
Israel (1) (Structural adjustment soft loan)	22.07.91	91/408/EC	187,5	Mar. 1992	187,5	187,5	
Algeria I (BOP loan)	23.09.91	91/510/EC	400	Jan. 1992 Aug. 1994	250 150	400	
Albania I (BOP grant)	28.09.92	92/482/EC	70	Dec. 1992 Aug. 1993	35 35	70	
Bulgaria II (BOP loan)	19.10.92	92/511/EC	110	Dec. 1994 Aug. 1996	70 40	110	
Baltics (BOP loans) of which :	23.11.92	92/542/EC	220			135	85 (Suspended)
Estonia			(40)	Mar. 1993	20	(20)	(20)
Latvia			(80)	Mar. 1993	40	(40)	(40)
Lithuania			(100)	Jul. 1993 Aug. 1995	50 25	(75)	(25)
Romania II (BOP loan)	27.11.92	92/551/EC	80	Feb. 1993	80	80	
Moldova I (BOP loan)	13.06.94	94/346/EC	45	déc-94 Aug. 1995	25 20	45	
Romania III (BOP loan)	20.06.94	94/369/EC	125	Nov. 1995 Sep. 1997 Dec. 1997	55 40 30	125	
Albania II (BOP grant)	28.11.94	94/773/EC	35	Jun. 1995 Oct. 1996	15 20	35	
Algeria II (BOP loan)	22.12.94	94/938/EC	200	Nov. 1995	100	100	100 (Suspended)
Slovakia (BOP loan)	22.12.94	94/939/EC	130	Jul. 1996			130 (Cancelled)
Ukraine I (BOP loan)	22.12.94	94/940/EC	85	Dec. 1995	85	85	
Belarus (BOP loan)	10.04.95	95/132/EC	55	Dec. 1995	30	30	25 (Suspended)
Ukraine II (BOP loan)	23.10.95	95/442/EC	200	Aug. 1996 Oct. 1996 Sep. 1997	50 50 100	200	
Moldova II (BOP loan)	25.03.96	96/242/EC	15	Dec. 1996	15	15	
FYROM I (BOP loan)	22.07.97	97/471/EC	40	Sep. 1997 Feb. 1998	25 15	40	
Bulgaria III (BOP loan)	22.07.97	97/472/EC	250	Feb. 1998 Dec. 1998	125 125	250	

Armenia, Georgia and Tajikistan (2) (Structural adjustment loans and grants) of which	17.11.97 28.3.00	97/787/EC modified by 00/244/EC	375			260	115
Armenia			(58)	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant) Dec. 2002 (grant)	28 8 4 5,5 5,5	(51)	(7)
Georgia			(175)	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant)	110 10 9 6	(135)	(40)
Tajikistan			(95)	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant)	60 7 7	(74)	(21)
Ukraine III (BoP loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	150	Jul. 1999	58	58	92 (Cancelled)
Albania III (BOP loan)	22.04.99	99/282/EC	20				20
Bosnia I (3) (BOP loan and grant)	10.05.99 10.12.01	99/325/EC modified by 01/899/EC	60	Dec. 1999 (grant) Dec. 1999 (loan) Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (grant)	15 10 10 10 15	60	
Bulgaria IV (BOP loan)	08.11.99	99/731/EC	100	Dec. 1999 Sep. 2000	40 60	100	
FYROM II (4) (BOP loan and grant)	08.11.99 10.12.01	99/733/EC modified by 01/900/EC	80 18	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant)	20 10 12 10	52	28 18
Romania IV (BOP loan)	08.11.99	99/732/EC	200	Jun. 2000	100	100	100
Kosovo I (5) (Grant budgetary support)	19.02.00	00/140/EC	35	Mar. 2000 Aug. 2000	20 15	20 15	
Montenegro (5) (Grant budgetary support)	22.05.00	00/355/EC	20	Aug. 2000 Dec. 2000	7 13	20	
Moldova III (BOP loan)	10.07.00 19.12.02	00/452/EC 02/1006/EC	15				15 (Cancelled)
Kosovo II (3) (Grant budgetary support)	27.06.01	01/511/EC	30	Sep. 2001 Dec. 2002	15 15	30	
Serbia and Montenegro (ex FRY) I (6) (BOP loan and grant)	16.07.01 10.12.01	01/549/EC modified by 01/901/EC	345	Oct. 2001 Oct. 2001 Jan. 2002 Aug. 2002	225 (loan) 35 (grant) 40 (grant) 45 (grant)	345	
Ukraine IV (BOP loan)	12.07.02	02/639/EC	110				110
Serbia and Montenegro II (ex FRY) (7)	05.11.02	02/882/EC	130	Dec. 2002	30		100
Bosnia II (8)	05.11.02	02/883/EC	60				60
Moldova IV	19.12.02	02/1006/EC	15				15
TOTAL			6100,5 (9)			4827,5	1273

- (1) Assistance to Israel includes a loan principal amount of €160 million and grants of €27.5 million in the form of interest subsidies.
- (2) Exceptional financial assistance, which includes a ceiling of euro 245 million for the loans and a ceiling of euro 130 million for the grants
Out of the global amount of euro 375 million, maximum amounts of euro 58 million, euro 175 million and euro 95 million were actually agreed with the beneficiary countries.
- (3) Includes a loan principal amount of up to €20 million and grants of up to €40 million.
- (4) Includes a loan principal amount of up to €50 million and grants of up to €48 million.
- (5) Exceptional financial assistance.
- (6) Includes a loan principal amount of €225 million and grants of €120 million.
- (7) Includes a loan principal amount of €55 million and grants of €75 million
- (8) Includes a loan principal amount of €20 million and grants of €40 million
- (9) Gross amount

**ANNEX 1B - COMMUNITY MACRO-FINANCIAL AND EXCEPTIONAL FINANCIAL ASSISTANCE
TO THIRD COUNTRIES BY REGION**

Status of effective disbursements as of end-December 2002 (in millions of euro)

Status of effective disbursements as of end-December 2002 (in millions of euro)							
Country	Authorisations			Disbursements			Undisbursed
	Date of Council Decision	Reference of Council Decision	Maximum amount	Dates of disbursements	Amounts of disbursements	Totals	
<u>A. EU Accession countries</u>							
Baltics (BOP loans) of which :	23.11.92	92/542/EC	220			135	85 (Suspended)
Estonia			(40)	Mar. 1993	20	(20)	(20)
Latvia			(80)	Mar. 1993	40	(40)	(40)
Lithuania			(100)	Jul. 1993 Aug. 1995	50 25	(75)	(25)
Bulgaria I (BOP loan)	24.06.91	91/311/EC	290	Aug. 1991 Mar. 1992	150 140	290	
Bulgaria II (BOP loan)	19.10.92	92/511/EC	110	Dec. 1994 Aug. 1996	70 40	110	
Bulgaria III (BOP loan)	22.07.97	97/472/EC	250	Feb. 1998 Dec. 1998	125 125	250	
Bulgaria IV (BOP loan)	08.11.99	99/731/EC	100	Dec. 1999 Sep. 2000	40 60	100	
Czech and Slovak Federal Republic (BOP loan)	25.02.91	91/106/EC	375	Mar. 1991 Mar. 1992	185 190	375	
Hungary I (Structural adjustment loan)	22.02.90	90/83/EC	870	Apr. 1990 Feb. 1991	350 260	610	260 (Suspended)
Hungary II (BOP loan)	24.06.91	91/310/EC	180	Aug. 1991 Jan. 1993	100 80	180	
Romania I (BOP loan)	22.07.91	91/384/EC	375	Jan. 1992 Apr. 1992	190 185	375	
Romania II (BOP loan)	27.11.92	92/551/EC	80	Feb. 1993	80	80	
Romania III (BOP loan)	20.06.94	94/369/EC	125	Nov. 1995 Sep. 1997 Dec. 1997	55 40 30	125	
Romania IV (BOP loan)	08.11.99	99/732/EC	200	Jun. 2000	100	100	100
Slovakia (BOP loan)	22.12.94	94/939/EC	130			Cancelled (Jul. 1996)	130 Cancelled
TOTAL A			3305			2730	575

B. Western Balkans

Albania I (BOP grant)	28.09.92	92/482/EC	70	Dec. 1992 Aug. 1993	35 35	70	
Albania II (BOP grant)	28.11.94	94/773/EC	35	Jun. 1995 Oct. 1996	15 20	35	
Albania III (BOP loan)	22.04.99	99/282/EC	20				20 (Cancelled)
Bosnia I (1) (BOP loan and grant)	10.05.99 modified by 10.12.01	99/325/EC 01/899/EC	60	Dec. 1999 (grant) Dec. 1999 (loan) Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (grant)	15 10 10 10 15	60	
FYROM I (BOP loan)	22.07.97	97/471/EC	40	Sep. 1997 Feb. 1998	25 15	40	
FYROM II (2) (BOP loan and grant)	08.11.99 modified by 10.12.2001	99/733/EC 01/900/EC	80 18	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant)	20 10 12 10	52 18	28
Kosovo I (3) (Grant budgetary support)	19.02.00	00/140/EC	35	Mar. 2000 Aug. 2000	20 15	35	
Kosovo II (3) (Grant budgetary support)	27.06.01	01/511/EC	30	Sep. 2001 Dec. 2002	15 15	30	
Montenegro (3) (Grant budgetary support)	22.05.00	00/355/EC	20	Aug. 2000 Dec. 2000	7 13	20	
Serbia and Montenegro I (ex FRY) (4)	16.07.01 10.12.2001	01/549/EC modified by 01/901/EC	345	Oct. 2001 (grant) Oct. 2001 (loan) Jan. 2002 (grant) Aug. 2002 (grant)	35 225 40 45	345	
Serbia and Montenegro II (ex FRY) (5) (BOP loan and grant)	05.11.02	02/882/EC	130	Dec. 2002 (grant)	30	30	100
Bosnia II (6) (BOP loan and grant)	05.11.02	02/883/EC	60				60
TOTAL B			943			717	226

(1) Includes a loan principal amount of €20 million and grants of €40 million.

(2) Includes a loan principal amount of up to €50 million and grants of up to €48 million.

(3) Exceptional financial assistance.

(4) Includes a loan principal amount of €225 million and grants of €120 million.

(5) Includes a loan principal amount of €55 million and grants of €75 million

(6) Includes a loan principal amount of €20 million and grants of €40 million

C. New Independent States (NIS)

Armenia, Georgia and Tajikistan (7) (Structural adjustment loans and grants) of which	17.11.97 modified by 28.3.00	97/787/EC 00/244/EC	375			260	115
Armenia			(58)	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant) Dec. 2002 (grant)	28 8 4 5,5 5,5	(51)	(7)
Georgia			(175)	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant)	110 10 9 6	(135)	(40)
Tajikistan			(95)	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant)	60 7 7	(74)	(21)
Belarus (BOP loan)	10.04.95	95/132/EC	55	Dec. 1995	30	30	25 (Suspended)
Moldova I (BOP loan)	13.06.94	94/346/EC	45	déc-94 Aug. 1995	25 20	45	
Moldova II (BOP loan)	25.03.96	96/242/EC	15	Dec. 1996	15	15	
Moldova III (BOP loan)	10.07.00 19.12.02	00/452/EC 02/1006 EC	15				15 (cancelled)
Moldova IV (BOP grant)	19.12.02	02/1006/EC	15 <i>(15)</i>				15
Ukraine I (BOP loan)	22.12.94	94/940/EC	85	Dec. 1995	85	85	
Ukraine II (BOP loan)	23.10.95	95/442/EC	200	Aug. 1996 Oct. 1996 Sep. 1997	50 50 100	200	
Ukraine III (BoP loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	150	Jul. 1999	58	58	92 (cancelled)
Ukraine IV (BOP loan)	12.07.02	02/639/EC	110 <i>(15)</i>				110
TOTAL C			1065 (9)			693	372
<u>D. Mediterranean countries</u>							
Israel (8) (Structural adjustment soft loan)	22.07.91	91/408/EC	187,5	Mar. 1992	187,5	187,5	
Algeria I (BOP loan)	23.09.91	91/510/EC	400	Jan. 1992 Aug. 1994	250 150	400	
Algeria II (BOP loan)	22.12.94	94/938/EC	200	Nov. 1995	100	100	100 (Suspended)
TOTAL D			787,5			687,5	100
TOTAL A+B+C+D			6100,5 (9)			4827,5	1273

(7) Exceptional financial assistance, which includes a ceiling of euro 245 million for the loans and a ceiling of euro 130 million for the grants
Out of the global amount of euro 375 million, maximum amounts of euro 58 million, euro 175 million and euro 95 million were actually agreed with the beneficiary countries

(8) Assistance to Israel includes a loan principal amount of ECU 160 million and grants of ECU 27,5 million in the form of interest subsidies.

(9) Gross amount

**Annex 2: Balance of payments support to recipients of EU
macro-financial assistance by contributor, 1990-2002 (1)**

2a. In millions US\$

	1990	1991	1992	1994	1995	1996	1997	1998	1999	2000	2001	2002
IFT's	419	5607	1564	4086	1877	250	732	2800	1751	36	439	1403
IMF	219	4177	909	3206	1477	195	584	2200	1009	12	284	895
World Bank	200	1430	655	880	400	55	148	600	742	24	155	508
Bilaterals	1618	5600	708	11202	3885	67	582	336	872	238	3483	364
EU (2)	1108	2190	423	855	330	19	329	168	556	189	375	241
Other bilaterals (3)	511	1406	285	702	150	10	73		264	49	93	10
of which												
USA		35		100		10	15		75	13	22	
Japan	200	850	120	350	150		54		22	7		
Debt relief		2004		9645	3405	38	180		52		3015	113
Paris Club		554		4920					52		3015	109
London Club				4380								4
Other (4)		1450		345	3405	38	180					

2.b In percent of total commitments, including debt relief

	1990	1991	1992	1994	1995	1996	1997	1998	1999	2000	2001	2002
IFT's	21	50	69	27	33	79	56	94	67	13	11	79
IMF	11	37	40	21	26	62	44	74	38	4	7	51
World Bank	10	13	29	6	7	17	11	20	28	9	4	29
Bilaterals	79	50	31	73	67	21	44	6	33	87	89	21
EU (2)	54	20	19	6	6	6	25	6	21	69	10	14
Other bilaterals (3)	25	13	13	5	3	3	5		10	18	3	1
of which												
USA		0		1		3	1		3	5	1	
Japan	10	8	5	2	3		4		1	3		
Debt relief		18		63	59	12	14		2		77	6
Paris Club		5		32					2		77	6
London Club				29								
Other (4)		13		2	59	12	14					

2c. In percent of total commitments, excluding debt relief

	1990	1991	1992	1994	1995	1996	1997	1998	1999	2000	2001	2002
IFT's	21	61	69	72	80	90	65	92	68	13	48	85
IMF	11	45	40	57	63	70	52	59	39	4	31	54
World Bank	10	16	29	16	17	20	13	33	29	9	17	31
Bilaterals	79	39	31	28	20	10	35	8	32	87	53	15
EU (2)	54	24	19	15	14	7	29	8	21	69	41	14
Other bilaterals (3)	25	15	13	12	6	4	7		10	18	10	1
of which												
USA		0		2		4	1		3	5	2	
Japan	10	9	5	6	6		5		1			

- (1) Based on Council Decisions for EU operations.
No operation was decided in 1993.
- (2) EU macro-financial assistance.
- (3) Including EU Member States.
- (4) Syndicated commercial banks loan in favour of Algeria in 1991, debt relief in favour of Ukraine by Russia and Turkmenistan in 1994 and 1995, debt rescheduling in favour of Moldova by Russia in 1996 and debt rescheduling in favour of Bulgaria and FYROM in 1997

**Annex 2.1.: Balance of payments support to recipients of EU
macro-financial assistance by contributor, 2001-2002 a)
(in millions of US\$ and in percent of total commitments and disbursements)**

Balance of payments support 2001

	<u>Total</u>				<u>Kosovo</u>				<u>Federal Republic of Yugoslavia</u>			
	<u>Commitments</u>		<u>Disbursements</u>		<u>Commitments</u>		<u>Disbursements</u>		<u>Commitments</u>		<u>Disbursements</u>	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFT's	439	11	137	30	15	17	12	20	390	10	125	31
IMF	284	7	125	27					250	7	125	31
WB (policy based)	155	4	12	3	15	17	12	20	140	4		
Bilaterals	3483	89	325	70	71	83	47	80	3351	90	278	69
EU	375	10	269	58	49	57	35	60	310	8	234	58
USA	22	1	20	4	10	12	10	17	12	0	10	2
Japan												
Other bilaterals	71	2	36	8	12	14	2	3	59	2	34	8
Debt relief	3015	77							2970	79		
London Club												
Paris Club	3015	77							2970	79		
Other												
Total	3922	100	462	100	86	100	59	100	3741	100	403	100
FYROM												
	<u>Commitments</u>		<u>Disbursements</u>									
	mio US\$	%	mio US\$	%								
IFT's	34	36	2	100								
IMF	34	36	2	100								
WB (policy based)												
Bilaterals	61	64										
EU	16	17										
USA												
Japan												
Other bilaterals												
Debt relief	45	47										
London Club												
Paris Club	45	47										
Other												
Total	95	100	2	100								

Balance of payments support 2002

	<u>Total</u>				<u>Serbia and Montenegro</u>				<u>Bosnia and Herzegovina</u>			
	<u>Commitments</u>		<u>Disbursements</u>		<u>Commitments</u>		<u>Disbursements</u>		<u>Commitments</u>		<u>Disbursements</u>	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFT's	1403	79	816	85	995	87	455	76	103	79	89	96
IMF	895	51	333	35	820	72	295	49	40	31	26	28
WB (policy based)	258	15	483	50	175	15	160	27	63	48	63	68
Bilaterals	364	21	146	15	147	13	142	24	28	21	4	4
EU	241	14	108	11	113	10	108	18	24	18		
USA	104	6										
Japan												
Other bilaterals	10	1	10	1	10	1	10	2				
Debt relief	113	6	113	12	24	2	24	4	4	3	4	4
London Club	4	0	4	0					4	3	4	4
Paris Club	109	6	109	11	24	2	24	4				
Other												
Total	1767	100	962	100	1142	100	597	100	131	100	93	100

	<u>Moldova</u>				<u>Ukraine</u>			
	<u>Commitments</u>		<u>Disbursements</u>		<u>Commitments</u>		<u>Disbursements</u>	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFT's	55	100	22	100	250	57	250	100
IMF	35	64	12	55				
WB (policy based)	20	36	10	45	250	57	250	100
Bilaterals					189	43		
EU					104	24		
USA								
Japan								
Other bilaterals								
Debt relief					85	19		
London Club								
Paris Club					85	19		
Other								
Total	55	100	22	100	439	100	250	100

a) Disbursements are shown under the year of corresponding commitments.

ANNEX 3: Selected economic indicators

	1998	1999	2000	2001	2002	
					Programme (1)	Estimates
GDP at constant prices	(Percent change)					
Armenia	7,3	3,3	6,0	9,6	7,5	12,9
Bosnia-Herzegovina	10,0	10,0	5,0	5,5	2,3	3,9
Serbia and Montenegro	2,5	-15,7	6,7	4,0	4,0	4,0
FYROM	2,9	2,7	4,6	-4,6	4,0	0,3
Georgia	2,9	3,0	1,9	4,5	3,5	5,4
Kosovo	-	-	-	11,0	-	7,0
Moldova	-6,5	-3,1	2,1	6,1	4,8	7,2
Romania	-4,8	-1,2	2,1	5,7	5,0	4,9
Tajikistan	5,3	3,7	8,3	10,2	7,5	9,1
Ukraine	-1,9	-0,2	5,9	9,1	5,0	4,1
Consumer price (end year)	(Percent change)					
Armenia	-1,2	2,1	0,4	3,0	3,0	2,0
Bosnia-Herzegovina						
Federation	5,0	-1,0	2,0	2,0	1,5	-0,2
Republika Srpska	14,0	14,0	15,0	7,0	4,4	1,9
Serbia and Montenegro	44,0	50,0	115,0	39,0	20,0	14,0
FYROM	-2,4	2,6	4,9	5,3	2,7	1,1
Georgia	7,2	10,9	4,6	3,4	5,0	5,6
Kosovo	-	-	-	11,0	-	3,0
Moldova	18,2	43,8	18,5	6,4	8,0	4,4
Romania	40,6	54,8	40,7	30,3	22,0	17,8
Tajikistan	2,7	30,1	60,6	12,5	13,0	14,5
Ukraine	22,0	19,2	25,8	6,1	9,8	-0,6
Fiscal balance	(Percent of GDP)					
Armenia *	-4,7	-5,5	-4,6	-4,0	-3,3	-3,0
Bosnia-Herzegovina	-7,8	-9,1	-9,9	n.a.	-5,5	-4,0
Federation	-1,8	-1,3	-2,3	n.a.	-1,8	-0,9
Republika Srpska	-5,1	-5,2	-2,9	n.a.	-0,3	-0,2
Serbia and Montenegro	n.a.	n.a.	-0,9	-6,2	-5,3	-5,0
FYROM	-1,7	0,0	2,2	-6,7	-3,4	-5,9
Georgia *	-4,9	-5,0	-2,6	-1,6	-1,8	-1,5
Kosovo	-	-	-7,3	1,3	-	-6,6
Moldova	-10,6	-5,3	-2,0	-0,7	-2,3	-1,3
Romania	-5,4	-3,6	-4,0	-3,3	-2,9	-2,6
Tajikistan	-3,8	-3,1	-0,6	-0,1	-0,3	-1,0
Ukraine	-2,8	-2,4	-1,5	-1,6	-1,8	0,3
Current account	(Percent of GDP)					
Armenia **	-21,2	-16,6	-14,6	-9,5	-8,7	-8,5
Bosnia-Herzegovina	-18,9	-21,4	-20,9	-23,1	-20,7	-22,3
Serbia and Montenegro	-5,5	-7,5	-7,6	-12,6	-13,0	-12,0
FYROM	-9,6	-5,9	-8,5	-10,6	-9,3	-8,6
Georgia **	-10,7	-8,5	-5,4	-6,7	-6,2	-6,5
Kosovo	-	-	-	9,1	-	-2,0
Moldova	-17,3	-3,6	-8,4	-7,4	-7,2	-6,0
Romania	-7,0	-4,0	-3,9	-5,9	-5,6	-3,4
Tajikistan	-8,3	-3,4	-6,5	-7,2	-4,5	-4,2
Ukraine	-3,1	2,6	4,7	3,5	1,5	3,5
Official foreign exchange reserves (end year)	(Months of imports)					
Armenia	3,9	3,8	3,8	3,7	3,8	4,0
Bosnia-Herzegovina	0,8	2,2	2,5	5,1	6,4	4,7
Serbia and Montenegro	n.a.	1,1	1,3	2,8	3,0	3,4
FYROM	2,0	3,0	3,5	6,0	4,6	3,9
Georgia	1,0	1,2	1,0	1,4	1,7	1,7
Kosovo	-	-	-	-	-	-
Moldova	1,8	2,2	2,4	2,2	2,5	2,4
Romania	2,4	2,1	2,5	3,2	3,2	3,9
Tajikistan	1,5	1,7	2,1	1,9	2,3	2,3
Ukraine	0,6	0,8	1,0	1,9	2,5	2,5

(1) Programme targets set in IMF programmes, if any.

* On a cash basis.

** Excluding official transfers.

Sources: National authorities and IMF